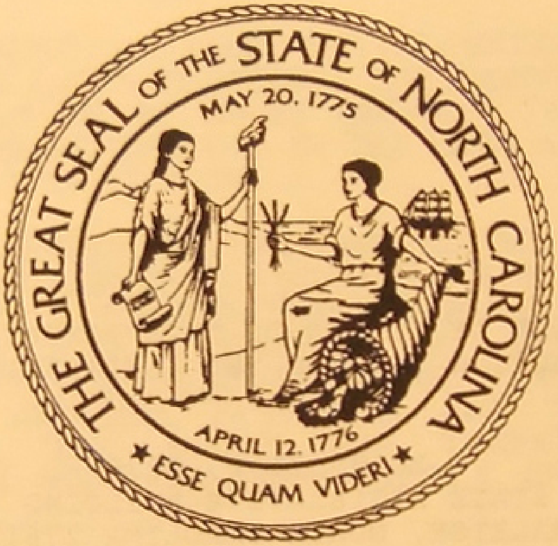
LEGISLATIVE

RESEARCH COMMISSION

REVENUE LAWS



REPORT TO THE
1989 GENERAL ASSEMBLY
OF NORTH CAROLINA
1990 SESSION

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TABLE OF CONTENTS

STATE OF NORTH CAROLINA

LEGISLATIVE RESEARCH COMMISSION

STATE LEGISLATIVE BUILDING

RALEIGH 27611

May 21, 1990

TO THE MEMBERS OF THE 1989 GENERAL ASSEMBLY (SECOND SESSION, 1990):

The Legislative Research Commission herewith submits to you for your consideration its final report on revenue laws. The report was prepared by the Legislative Research Commission's Revenue Laws Study Committee pursuant to Section 2.1(12) of Chapter 802 of the 1989 Session Laws.

Respectfully submitted,

Josephus L. Mavretic
Speaker

Henson P. Barnes
President Pro Tempore

Cochairmen
Legislative Research Commission

LEGISLATIVE RESEARCH COMMISSION

1989 - 1990

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PREFACE

The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is a general purpose study group. The Commission is co-chaired by the Speaker of the House of Representatives and the President Pro Tempore of the Senate and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

At the direction of the 1989 General Assembly, the Legislative Research Commission has undertaken studies of numerous subjects. These studies were grouped into broad categories and each member of the Commission was given responsibility for one category of study. The Co-chairs of the Legislative Research Commission, under the authority of G.S. 120-30.10(b) and (c), appointed committees consisting of members of the General Assembly and the public to conduct the studies. Co-chairs, one from each house of the General Assembly, were designated for each committee.

The study of the revenue laws and local government revenue sources was authorized by Section 2.1(12) of Chapter 802 of the 1989 Session Laws. That act states that the Commission may consider House Joint Resolution 3 and Senate Bill 1298 in determining the nature, scope, and aspects of the study. House Joint Resolution 3, introduced by Representative Daniel T. Lilley in the 1989 Session, gives the Legislative Research Commission's study of the revenue laws a very broad scope, stating that the "Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." In addition, the second edition of Senate Bill 1298 adopted in the 1989 Session recommends a study of "the need for additional local government revenue sources to supplement the property tax, local sales and use taxes, and other existing revenue sources." The relevant portions of Chapter 802, House Joint Resolution 3, and Senate Bill 1298 are included in Appendix A. The Legislative Research Commission grouped this study in its Taxation area under the direction of Representative John William Hurley. The Committee was chaired by Senator Dennis J. Winner and Representative Daniel T. Lilley. The full membership of the Committee and the staff assigned to the Committee are listed in Appendix B of this report.

COMMITTEE PROCEEDINGS

The Legislative Research Commission's Revenue Laws Study Committee met three times; the first two meetings were one-day meetings and the third meeting was a two-day meeting. The Committee devoted the majority of its time to fulfilling its mandate to study the impact of the sweeping tax changes made by the 1989 General Assembly. The Committee spent the remainder of its time considering proposals for various smaller substantive changes to the revenue laws and proposals for technical changes to the revenue laws. The Committee deferred discussion of options for additional local revenue sources until after the 1990 legislative session. A list of the speakers that appeared before the Study Committee is provided in Appendix C.

At its first meeting, the Committee reviewed the tax changes made by the 1989 General Assembly, focusing on the changes made by the legislation creating the North Carolina Highway Trust Fund, Chapter 692 of the 1989 Session Laws as amended by Chapters 700, 770, 788, and 799, and the changes made by the Tax Fairness Act of 1989, Chapter 728. The Trust Fund legislation repealed the sales tax on motor vehicles, imposed a titling tax on certificates of title issued for motor vehicles, increased the gasoline tax, increased various fees, and made numerous other changes. The Tax Fairness Act restructured the State's individual income tax as a percentage of federal taxable income and recognized S Corporations effective for the 1989 tax year. At its first meeting, the Committee also reviewed the success of its recommendations to the 1989 Session. Appendix D lists these recommendations and their status.

The Committee devoted most of its second meeting and part of its third meeting to the consideration of problems and concerns resulting from the Highway Trust Fund legislation. The Committee reviewed issues raised by taxpayers, the Department of Revenue, the Division of Motor Vehicles, Committee members, and State agencies affected by the titling tax. The Committee found several areas of the law that need technical change to effect the purposes of the legislation and several areas that need change to make the legislation fair and easier to administer. Legislative Proposal 1 contains the Committee's recommendations concerning the Trust Fund legislation.

The Committee devoted most of its third meeting to the consideration of problems and concerns resulting from the Tax Fairness Act. The Committee reviewed issues raised by the North Carolina Bar Association, the North Carolina Association of Certified Public Accountants, the Department of Revenue, taxpayers, and Committee

members. The Committee discussed problems created by the "speeded-up" recognition of S Corporations, taxpayers' complaints about the repeal of the special exemptions for various medical conditions, whether to adopt the federally indexed personal exemption and standard deduction amounts for the 1990 tax year, and various technical changes that need to be made. The Committee's recommendations related to the Tax Fairness Act are included in Legislative Proposals 2, 3, and 5.

Although the Committee focused on problems and concerns raised by the two major tax acts of the 1989 Session, the Committee also considered several proposals for miscellaneous changes in the revenue laws. The Committee considered whether to allow land owned by a trust to qualify for use-value classification under the property tax laws, whether to make uniform the time for appealing property tax decisions made by different units of local government, whether to increase the bond required for distributors of gasoline and suppliers of diesel fuel, whether to exempt fuel used by a small power producer from sales tax, and whether to modify the taxation of a North Carolina Enterprise Corporation.

The Committee declined to make a recommendation on the first of these smaller issues it considered, deciding that the issue should be referred to the Property Tax Study Commission. The Committee made recommendations on the other issues. Legislative Proposals 4, 6, 7, and 8 contain the Committee's recommendations on these issues.

Finally, the Committee addressed numerous technical changes that need to be made to the revenue laws. Legislative Proposal 9 contains the Committee's recommendations for technical changes.

The Committee expresses its appreciation for the assistance of Ms. Helen Powers, Secretary of Revenue, Mr. Myron Banks, Deputy Secretary of Revenue, the staff of the Department of Revenue, and the staff of the Division of Motor Vehicles. The Committee's task is made easier by the informed comments and suggestions of these tax administrators.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee recommends the following legislation to the 1990 Session of the 1989 General Assembly. The Committee's legislative proposals consist of nine bills. The proposals cover a broad range of topics, including revisions to the new Highway Use Tax that applies when a title is issued for a motor vehicle, transitional adjustments to the Tax Fairness Act of 1989, tax relief for taxpayers with disabled dependents, and numerous technical and clarifying amendments to the revenue laws. Each proposed bill is followed by an explanation of the proposal and a fiscal note indicating the anticipated revenue gain or loss resulting from the proposal.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S OR H D

PROPOSAL 1 (90-LJX-R15)
THIS IS A DRAFT

Short Title: Highway Use Tax/Sales Tax Changes. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REINSTATE SALES TAX ON CERTAIN VEHICLES AND VEHICLE PARTS, TO MODIFY THE HIGHWAY USE TAX AND THE ALTERNATE GROSS RECEIPTS TAX, AND TO MAKE TECHNICAL CHANGES IN THE LAWS AFFECTED BY THE HIGHWAY TRUST FUND.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3(8b) reads as rewritten:

"(8b) 'Motor vehicle' means ~~any vehicle which is self-propelled and designed primarily for use upon the highways, any vehicle which is propelled by electric power obtained from trolley wires but not operated upon rails, and any vehicle designed to run upon the highways which is propelled by a self-propelled vehicle, but shall not include any implement of husbandry, farm tractor, road construction or maintenance machinery or equipment, special mobile equipment as defined in G.S. 20-4.01, any vehicle designed primarily for use in work off the highway, or a manufactured home.~~ <u>a vehicle that is designed primarily for use upon the highways and is either self-propelled or propelled by a self-propelled vehicle, but does not include:</u>

a. A moped as defined in G.S. 20-4.01(27)(d1).
b. Special mobile equipment as defined in G.S. 20-4.01(44).
c. A tow dolly that is exempt from motor vehicle title and registration requirements under G.S. 20-51(10) or (11).
d. A farm tractor or other implement of husbandry.
e. A manufactured home.
f. Road construction or road maintenance machinery or equipment."

Sec. 2. G.S. 105-164.13(32) reads as rewritten:

"(32) Sales of motor vehicles, the ~~separate sales~~ sale of a motor vehicle body ~~and a motor vehicle chassis when the body is~~ to be mounted on ~~the chassis,~~ a motor vehicle chassis when a certificate of title has not been issued for the chassis, and the sale of a motor vehicle body mounted on a motor vehicle chassis that temporarily enters the State so the manufacturer of the body can mount the body on the chassis. ~~of the sale.~~"

Sec. 3. G.S. 105-164.3(7a) reads as rewritten:

"(7a) 'Lease or rental' means ~~the leasing or renting of tangible personal property and the possession or use thereof by the lessee or renter for a consideration without transfer of the title of such property.~~ a transfer, for consideration, of the use but not the ownership of property to another for a period of time."

Sec. 4. G.S. 105-187.1 reads as rewritten:

"§ 105-187.1. Definitions.

The following definitions and the definitions in G.S. 105-164.3 apply to this Article:

(1) 'Commissioner' means the Commissioner of Motor Vehicles.
(2) 'Division' means the Division of Motor Vehicles, Department of Transportation.
(3) 'Long-term lease or rental' means a lease or rental made under a written agreement to lease or rent property to the same person for a period of at least 365 continuous days.

(4) 'Short-term lease or rental' means a lease or rental that is not a long-term lease or rental."

Sec. 5. G.S. 105-187.5(b) reads as rewritten:

"(b) Rate. The tax rate on the gross receipts ~~of~~ from the short-term lease or rental of a motor vehicle is eight percent ~~(8%), unless the vehicle is leased or rented to the same person for a period of more than 90 continuous days. In that circumstance, the tax is eight percent (8%) for the first 90 days the vehicle is leased or rented to the same person and is three percent (3%) for the remainder of the period during which the vehicle is leased or rented to that person.~~ (8%) and the tax rate on the gross receipts from the long-term lease or rental of a motor vehicle is three percent (3%). The maximum tax in G.S. 105-187.3(a) applies to ~~the~~ each lease or rental of a motor vehicle ~~when the vehicle is leased or rented to the same person for more than 90 continuous days~~. ~~Tax paid by a person from the first day of a continuous lease or rental period applies toward the maximum tax~~."

Sec. 6. G.S. 105-187.3(a) reads as rewritten:

"(a) Amount. The rate of the use tax imposed by this Article is three percent (3%) of the retail value of a motor vehicle for which a certificate of title is issued. The tax is payable as provided in G.S. 105-187.4. The tax may not be less than ~~forty dollars ($40.00)~~ twenty dollars ($20.00) for each motor vehicle for which a certificate of title is issued, unless the issuance of a title for the vehicle is exempt from tax under G.S. 105-187.6(a). The tax may not be more than one thousand dollars ($1,000) for each motor vehicle for which a certificate of title is issued."

Sec. 7. G.S. 105-187.7 reads as rewritten:

"**§ 105-187.7. Credit for tax paid in another state.**

A person who, within 90 days before applying for a certificate of title for a motor vehicle on which the tax imposed by this Article is due, has paid a sales tax, an excise tax, or a tax substantially equivalent to the tax imposed by this Article on the vehicle to a taxing jurisdiction outside this State is entitled to a credit against the tax due under this Article for the amount of tax paid to the other jurisdiction. The credit may not reduce the person's liability under this Article below the minimum ~~forty-dollar ($40.00) tax.~~ tax set in G.S. 105-187.3."

Sec. 8. G.S. 105-187.8 reads as rewritten:

"**§ 105-187.8. Refund for return of purchased motor vehicle.**

When a purchaser of a motor vehicle returns the motor vehicle to the seller of the motor vehicle within 90 days after the

purchase and receives a vehicle replacement for the returned vehicle or a refund of the price paid the seller, whether from the seller or the manufacturer of the vehicle, the purchaser may obtain a refund of the privilege tax paid on the certificate of title issued for the returned motor vehicle, less the minimum tax ~~of forty dollars ($40.00).~~ set in G.S. 105-187.3.

To obtain a refund, the purchaser must apply to the Division for a refund within 30 days after receiving the replacement vehicle or refund of the purchase price. The application must be made on a form prescribed by the Commission and must be supported by documentation from the seller of the returned vehicle."

Sec. 9. G.S. 105-187.4(b) reads as rewritten:

"(b) Sale by Retailer. When a certificate of title for a motor vehicle is issued because of a sale of the motor vehicle by a retailer, the applicant for the certificate of title must attach the bill of sale for the motor vehicle to the application. A retailer who sells a motor vehicle may collect from the purchaser of the vehicle the tax payable upon the issuance of a certificate of title for the vehicle, apply for a certificate of title on behalf of the purchaser, and remit the tax due on behalf of the purchaser. If a check submitted by a retailer in payment of taxes collected under this section is not honored by the financial institution upon which it is drawn because the retailer's account did not have sufficient funds to pay the check or the retailer did not have an account at the institution, the Division may suspend or revoke the license issued to the retailer under Article 12 of Chapter 20 of the General Statutes."

Sec. 10. G.S. 20-294 reads as rewritten:

"**§ 20-294. Grounds for denying, suspending or revoking licenses.**

A license may be denied, suspended or revoked on any one or more of the following grounds:

(1) Material misstatement in application for license.

(2) Willful and intentional failure to comply with any provision of this Article or Article 15 or the willful and intentional violation of G.S. 20-52.1, 20-75, 20-79, 20-82, 20-108, 20-109 or rescission and cancellation of dealer's license and dealer's plates under G.S. 20-110(e) or 20-110(f) or any lawful rule or regulation promulgated by the Division under this Article.

(3) Being a motor vehicle dealer, failure to have an established place of business as defined in this Article.

(4) Willfully defrauding any retail buyer, to the buyer's damage, or any other person in the conduct of the licensee's business.

(5) Employment of fraudulent devices, methods or practices in connection with compliance with the requirements under the laws of this State with respect to the retaking of motor vehicles under retail installment contracts and the redemption and resale of such motor vehicles.

(6) Having used unfair methods of competition or unfair deceptive acts or practices.

(7) Knowingly advertising by any means, any assertion, representation or statement of fact which is untrue, misleading or deceptive in any particular relating to the conduct of the business licensed or for which a license is sought.

(8) Knowingly advertising a used motor vehicle for sale as a new motor vehicle.

(9) Conviction of an offense set forth under G.S. 20-106, 20-106.1, 20-107, 20-112 while holding such a license or within five years next preceding the date of filing the application; or conviction of a felony involving moral turpitude under the laws of this State, any other state, territory or the District of Columbia or of the United States.

(10) Submitting a bad check to the Division of Motor Vehicles in payment of highway use taxes collected by the licensee."

Sec. 11. G.S. 105-187.5(d) reads as rewritten:

"(d) ~~Reporting~~ Administration. The Division shall notify the Secretary of Revenue of a retailer who makes the election under this section. A retailer who makes this election shall report and remit to the Secretary the tax on the gross receipts of the lease or rental of the motor vehicle ~~as if the gross receipts were taxable under G.S. 105-164.4(a)(2)~~ . The Secretary shall administer the tax imposed by this section on gross receipts in the same manner as the tax levied under G.S. 105-164.4(a)(2). The administrative provisions and powers of the Secretary that apply to the tax levied under G.S. 105-164.4(a)(2) apply to the tax imposed by this section. In addition, the Division may request the Secretary to audit a retailer who elects to pay tax on gross receipts under this section. When the Secretary conducts an audit at the request of the Division, the Division

shall reimburse the Secretary for the cost of the audit, as determined by the Secretary."

Sec. 12. G.S. 105-187.6 reads as rewritten:

"**§ 105-187.6. Exemptions from highway use tax.**

(a) Full Exemptions.-- The tax imposed by this Article does not apply when a certificate of title is issued as the result of a transfer of a motor vehicle:

(1) To the insurer of the motor vehicle under G.S. 20-109.1 because the vehicle is a salvage vehicle.

(2) To either a manufacturer, as defined in G.S. 20-285, or a motor vehicle retailer for the purpose of ~~resale.~~ resale other than lease or rental.

(3) To the same owner to reflect a change or correction in the owner's name.

(4) To the Department of Human Resources to be equipped by the Department for use by the handicapped and then transferred to a handicapped person.

(5) To the State or a local board of education when the motor vehicle is a school bus and is to be used for public school transportation.

(6) To a local board of education when the motor vehicle is to be used in the driver education program of a public school to train students to drive.

(7) By will or intestacy.

(b) Partial Exemptions.-- Only the minimum tax imposed by this Article applies when a certificate of title is issued as ~~a~~ the result of ~~the~~ a transfer of a motor vehicle:

(1) By a gift between a husband and wife or a parent and child.

~~(2) By will or intestacy.~~

~~(3)~~ (2) By a distribution of marital property as a result of a divorce.

~~(4)~~ (3) To a secured party who has ~~filed~~ a perfected security interest in the motor vehicle ~~with the Department of the Secretary of State~~.

~~(5)~~ (4) To a partnership or corporation as an incident to the formation of the partnership or corporation and no gain or loss arises on the transfer under section 351 or section 721 of the Internal Revenue Code, or to a corporation by merger or consolidation in accordance with G.S. 55-110.

~~(6) To the same owner to reflect a change in the owner's name.~~

(c) Out-of-state Vehicles.-- A maximum tax of one hundred dollars ($100.00) applies when a certificate of title is issued for a motor vehicle that, at the time of applying for a certificate of title, is and has been titled in another state for at least 90 days."

Sec. 13. Article 5A of Chapter 105 of the General Statutes is amended by adding a new section to read:

<u>**"§ 105-187.11. Transition from sales tax to highway use tax for lessors and renters of motor vehicles.**</u>

<u>A tax at the rate set in G.S. 105-187.5(b) is levied on the gross receipts derived by a retailer from the lease or rental of a motor vehicle owned by the retailer before October 1, 1989, and leased or rented on or after that date. A retailer subject to this tax may elect to pay highway use tax at the rate set in G.S. 105-187.3(a) on a motor vehicle owned by the retailer before October 1, 1989, and leased or rented on or after that date. The retail value of a motor vehicle for which a retailer makes an election under this section is the value of the motor vehicle that would apply under G.S. 105-187.3(b) if the retailer received the vehicle because of a reason other than the sale of the motor vehicle on the date the retailer makes the election.</u>

<u>To make the election allowed by this section, a retailer shall complete a form provided by the Division, pay the tax due, and pay the fee set in G.S. 20-85(a)(9). A retailer who makes this election may not receive credit for any tax paid on the motor vehicle under Article 5 of this Chapter or for any tax on gross receipts paid under this Article. The Division shall notify the Secretary of Revenue of a retailer who makes an election under this section."</u>

Sec. 14. Section 4 of Chapter 753 of the 1989 Session Laws reads as rewritten:

"Sec. 4. ~~These refunds~~ <u>Refunds for taxable periods ending on or before October 1, 1989,</u> shall be drawn from the Highway Fund. <u>Refunds for taxable periods ending after October 1, 1989, shall be drawn from the Highway Fund and the Highway Trust Fund in the same percentage amounts that refunds are drawn from these Funds under G.S. 105-445."</u>

Sec. 15. G.S. 20-57(b) reads as rewritten:

"(b) The registration card shall be delivered to the owner and shall contain upon the face thereof the name and address of the owner, space for <u>the</u> owner's signature, the registration number assigned to the vehicle, and ~~such~~ <u>a</u> description of the vehicle as

determined by the Commissioner, provided that if there are more than two owners the Division may show only two owners on the registration card and indicate that additional owners exist by placing after the names listed "et al." ~~Upon application to the Division, the registered owner may acquire additional copies of the registration card at a fee of three dollars ($3.00) each.~~ An owner may obtain a copy of a registration card issued in the owner's name by applying to the Division for a copy and paying the fee set in G.S. 20-85."

Sec. 16. G.S. 20-85(a) reads as rewritten:

"(a) ~~Except as provided in G.S. 20-68, the following fees concerning a certificate of title for a motor vehicle and registration of a motor vehicle shall be paid to the Division.~~ The following fees are imposed concerning a certificate of title, a registration card, or a registration plate for a motor vehicle. These fees are payable to the Division and are in addition to the tax imposed by Article 5A of Chapter 105 of the General Statutes.

(1) Each application for certificate of title....$35.00

(2) Each application for duplicate or corrected certificate of title............ 10.00

(3) Each application of repossessor for certificate of title............................ 10.00

(4) Each transfer of registration................. 10.00

(5) Each set of replacement registration plates.................................... 10.00

(6) Each application for duplicate registration ~~certificate~~ card............................ 10.00

(7) Each application for recording supplementary lien.. 10.00

(8) Each application for removing a lien from a certificate of title.......................... 10.00

(9) Each application for certificate of title for a motor vehicle transferred to a manufacturer, as defined in G.S. 20-285, or a motor vehicle retailer for the purpose of resale... 10.00."

Sec. 17. G.S. 20-85.1(c) reads as rewritten:

"(c) All funds collected under ~~this section~~ subsection (a) shall be ~~deposited in~~ credited to the Highway Fund. One-half of the funds collected under subsection (b) shall be credited to the Highway Trust Fund and the remaining one-half shall be credited to the Highway Fund."

Sec. 18. Sections 1 through 8 of this act shall become effective July 1, 1990. The remaining sections of this act are effective upon ratification.

Explanation of Proposal 1

The 1989 General Assembly established a $9.1 billion highway program, created the North Carolina Highway Trust Fund to provide a separate source of funds for the program, and raised various taxes and fees to provide revenue for the Trust Fund. As part of the tax and fee increases, the General Assembly increased the motor fuel tax, repealed the 2%, $300 maximum sales tax on motor vehicles and replaced that tax with a 3%, $1000 maximum "highway use tax," increased the fee for issuing a certificate of title from $5.00 to $35.00, and increased related motor vehicle title and registration fees from varying amounts to $10.00.

As part of its charge to study the impact of tax changes made in the 1989 Session, the Revenue Laws Study Committee considered the changes made by the Trust Fund legislation and the problems and concerns voiced about these changes by legislators, taxpayers, State departments, and local governmental units. The Committee identified several areas in need of technical amendment as well as several areas that need change to make the new highway use tax fair to taxpayers and easier to administer. Legislative Proposal 1 includes all changes concerning the 1989 Trust Fund legislation that are recommended by the Committee. These changes are described by subject matter below.

-----Reinstate Sales Tax On Mopeds and Tow Dollies

(Section 1 of Proposal 1)

The Highway Trust Fund legislation exempted motor vehicles from sales tax and imposed a titling tax, called a "highway use tax," on motor vehicles effective October 1, 1989. Mopeds and tow dollies are included in the sales tax definition of motor vehicle and are therefore exempt from sales tax. A moped is a motor vehicle that cannot go faster than 20 miles an hour and has a motor that does not exceed 50 cubic centimeters. A tow dolly is either an axle with a fifth wheel that is used to link two semi-trailers together behind a truck tractor or a device used to tow disabled vehicles that weigh less than 5,000 pounds.

As motor vehicles, mopeds and tow dollies are currently exempt from sales tax and are theoretically subject to the highway use tax. The highway use tax, however, is payable when a certificate of title is issued for a motor vehicle rather than when a

motor vehicle is purchased. Mopeds and tow dollies are not required to be titled and therefore escape taxation under the highway use tax.

The Revenue Laws Study Committee concluded that the exemption of mopeds and tow dollies from sales tax when the items are not subject to the new highway use tax is an unintended result of the Trust Fund legislation and that mopeds and tow dollies should either be subject to sales tax or be required to be titled and taxed under the highway use tax. Before October 1, 1989, mopeds and tow dollies were subject to sales tax at the rate of 2%, with a $300 cap.

The Committee decided that it was better to reinstate sales tax on mopeds and tow dollies than to require them to be titled. Accordingly, Section 1 of Proposal 1 imposes sales tax on mopeds and tow dollies at the general State rate of 3% and the local rate of 2% for a combined rate of 5%. The Committee found that mopeds are more like bicycles than cars and trucks and should therefore be subject to the same sales tax rate as bicycles, which is 5%. The Committee further found that a tow dolly is a kind of motor vehicle part and accessory and should therefore be taxed at the same sales tax rate as other motor vehicle parts and accessories, which is 5%. The proposal is effective July 1, 1990.

Like other sales tax revenue, the 3% State sales tax revenue from mopeds and tow dollies will be placed in the General Fund. The local 2% sales tax revenue will be distributed to local units of government.

-----Reinstate Sales Tax on Certain Motor Vehicle Bodies
(Section 2 of Proposal 1)

Under the sales tax law in effect until October 1, 1989, the separate sales of a motor vehicle chassis and a motor vehicle body to be installed on the chassis were considered a single sale in applying the 2%, $300 maximum sales tax. The Trust Fund legislation exempted motor vehicles as well as motor vehicle bodies from sales tax. The legislation exempted motor vehicle bodies so that motor vehicle bodies and motor vehicle chassis that are sold separately would continue to be treated as a single article and taxed under the highway use tax. The exemption was enacted under the assumption that highway use tax would be collected on the combined chassis and body when a certificate of title was issued for the resulting motor vehicle.

The Revenue Laws Study Committee found that this assumption is mistaken when a motor vehicle body is installed on a chassis that has already been titled. Frequently, for example, a truck body is damaged and the truck owner has a new body installed on

the truck. Because no new certificate of title is required in this circumstance, no highway use tax is due. The truck body, however, has escaped taxation under both the sales tax and the highway use tax.

The Committee therefore recommends that motor vehicle bodies that are installed on titled chassis be subject to sales tax at the general State rate of 3% and the local rate of 2%, for a combined rate of 5%. The Committee decided that a motor vehicle body is a kind of motor vehicle part and accessory and should be taxed at the same rate as other motor vehicle parts and accessories, which is 5%. Section 2 of Proposal 1 imposes sales tax on these motor vehicle bodies effective July 1, 1990.

-----Establish A Uniform Long-Term Leasing Rate

(Sections 3, 4, and 5 of Proposal 1)

As part of the repeal of the sales tax on motor vehicles, the Trust Fund legislation repealed the 2%, $300 maximum tax on the gross receipts from the lease or rental of a motor vehicle. In its place, the legislation created an optional gross receipts tax that lessors and renters of motor vehicles can elect to pay instead of paying the 3%, $1,000 maximum highway use tax.

The optional tax is 8% of gross receipts for the first 90 days of a lease or rental to the same person and 3% of gross receipts after that. A lease or rental that extends for more than 90 days is therefore subject to two different rates: 8% for the first 90 days and 3% after that. Tax collected at the 8% rate, however, applies towards the $1,000 maximum for a lease or rental to the same person. Revenue from the 8% gross receipts tax is credited to the General Fund and revenue from the 3% gross receipts tax is credited to the Trust Fund.

The rationale of establishing different rates for rentals and leases of different lengths of time is that a long-term lease is similar to the purchase of a vehicle and should therefore be taxed at the same rate as an actual purchase of a vehicle. A vehicle purchased by someone who is not going to lease or rent the vehicle is subject to the 3%, $1,000 maximum highway use tax.

The Revenue Laws Study Committee heard numerous complaints about the two-tiered tax rate on long-term leases and rentals from representatives of the long-term leasing industry. The representatives explained that the two-tiered rate was costly to administer and was forcing lessors to pay the highway use tax rather than exercise the option of paying on gross receipts.

The Revenue Laws Study Committee determined that the concerns of the leasing industry were valid and that a 3% uniform long-term leasing rate could be established. To offset any reduction in revenue from decreasing the rental rate for the first 90 days of a long-term lease from 8% to 3%, the Committee recommends that the 8% rate apply to all leases or rentals for less than a year and that the 3% rate apply to all leases or rentals made under a contract to lease or rent a motor vehicle for at least one year.

Sections 3, 4, and 5 of Proposal 1 implement this recommendation. Section 3 amends the definition of lease or rental so the definition can be applied without redundancy when referring to a long-term lease or rental and a short-term lease or rental. Section 4 adds definitions of "long-term lease or rental" and "short-term lease or rental." Section 5 rewrites the statute that sets out the alternate gross receipts tax to set the rate at 8% for a short-term lease or rental and 3% for a long-term lease or rental. The recommendation is effective July 1, 1990.

As recommended, a long-term lease or rental of a motor vehicle is a lease or rental made under a written contract to lease or rent a vehicle to the same person for at least one year. A short-term lease or rental is any other lease or rental. Thus, if a vehicle is leased under a written three-year lease, the tax rate on the gross receipts for the entire period of the lease is 3%. Similarly, if a vehicle is leased under a written two-year lease and the lease is terminated before the end of the first year of the lease, the tax rate for the entire period the vehicle was actually leased is nevertheless 3%. If a vehicle is rented on a month-to-month basis, for a fixed period of less than 1 year, or on the basis of an oral agreement, the tax rate on the gross receipts for the entire period of the rental is 8%.

-----Lower the Minimum Highway Use Tax From $40 To $20

(Sections 6, 7, and 8 of Proposal 1)

The Trust Fund legislation repealed the 2%, $300 maximum sales tax on motor vehicles and replaced it with the highway use tax. The highway use tax is 3% of the retail value of a motor vehicle but cannot be less than $40.00 nor more than $1,000. In addition to the $40.00 minimum highway use tax, a titling fee of $35.00 plus a registration plate fee of $10.00 must be paid when a certificate of title is issued for a newly-acquired motor vehicle.

Members of the Revenue Laws Study Committee received correspondence from constituents who are concerned about the high minimum tax, particularly when it is applied to motor vehicles of low value. The Committee debated the issue and

determined that the minimum tax is very regressive, particularly when coupled with the $35.00 fee, and that it is not fair to collect the same amount of tax on a vehicle valued at $1,300 as on a vehicle valued at $250.00.

The Committee therefore recommends that the minimum tax be lowered from $40.00 to $20.00. The Committee debated eliminating the minimum tax so that all motor vehicles would be taxed under the highway use tax on the basis of value only. The Committee declined to recommend eliminating the minimum tax out of concern for the loss of Trust Fund revenue resulting from the recommendation.

Sections 6, 7, and 8 of Proposal 1 implement this recommendation. Section 6 lowers the minimum tax to $20.00 and Sections 7 and 8 change references to the amount of the minimum tax. This recommendation is effective July 1, 1990.

Under this recommendation, motor vehicles ranging in value up to $690.00 are all subject to the same $20.00 minimum tax. Above this value, the amount of tax increases because 3% of the value is more than $20.00. The recommendation does not affect the $35.00 title fee.

-----Make Submission of Bad Checks In Payment Of The Highway Use Tax Grounds For Suspending Or Revoking A Dealer's License

The highway use tax imposed by the Trust Fund legislation must be paid before a certificate of title is issued for a motor vehicle. Because many motor vehicle dealers apply for a certificate of title for vehicles bought from them, the legislation allows a dealer to collect the highway use tax payable on a motor vehicle and remit the tax to the Division of Motor Vehicles when the dealer applies for a title on behalf of the buyer of the motor vehicle. The Division of Motor Vehicles has received approximately $15,000 in bad checks from dealers in payment of the highway use tax.

The Division asked the Committee to consider giving the Division a remedy for the submission of bad checks by dealers. Under current law, the Division can remove the registration plate from any vehicle for which a bad check was given in payment of the highway use tax. The Division noted that it does not seem fair to remove the plate from a vehicle when the owner of the vehicle paid the tax to a dealer and the dealer submitted a bad check to the Division.

In response to this request, the Committee recommends that the Division of Motor Vehicles be given the authority to revoke or suspend a motor vehicle dealer's license if the dealer submits a bad check to the Division in payment of the highway use tax. Sections 9 and 10 of Proposal 1 implement this recommendation.

Section 9 inserts a sentence in the highway use tax statutes that alerts those who collect the tax of the power to suspend or revoke a dealer's license. Section 10 amends the statute that lists the grounds for adverse action on various licenses concerning the sale of motor vehicles to add submitting bad checks in payment of the highway use tax as a grounds for adverse action. The recommendation is effective upon ratification.

-----Give The Department of Revenue The Authority to Audit Motor Vehicle Lessors and Renters Who Elect To Pay On Gross Receipts

(Section 11 of Proposal 1)

The gross receipts tax on motor vehicles is now an elective alternate to the highway use tax and is set out in the highway use tax statutes. The Division of Motor Vehicles collects the highway use tax, but the Department of Revenue collects the gross receipts tax. Under prior law, the gross receipts tax on motor vehicles was part of the sales tax law and was administered by the Department of Revenue.

Because the statutes that levy the gross receipts tax are now part of the statutes that are administered by the Division of Motor Vehicles rather than the Department of Revenue, the question arose of whether the Department's audit authority extends to those who pay the gross receipts tax to the Department. To resolve this question, the Committee recommends that the Department of Revenue be given the same authority to audit those who pay the gross receipts tax that it has to audit those who remit sales and use taxes. The Committee further recommends that the Division of Motor Vehicles be given specific authority to request the Department of Revenue to conduct an audit of a person who pays the gross receipts tax. Section 11 of Proposal 1 implements this recommendation.

-----Exempt Various Transfers of Motor Vehicles From The Highway Use Tax

(Section 12 of Proposal 1)

The Revenue Laws Study Committee heard numerous complaints from taxpayers about the imposition of the highway use tax on various transfers of motor vehicles. Taxpayers complained most about transfers that occur for a reason other than the sale of the vehicle. The most frequent complaint was lodged against transfers to the same owner because of a name change. The second most frequent complaint was about transfers to a beneficiary upon the death of the former owner.

Unlike the former sales tax on motor vehicles, which was payable only when a motor vehicle was sold, the highway use tax is payable every time a certificate of title is

issued for a motor vehicle. A title is issued every time a motor vehicle is transferred to a new owner or the owner changes names, regardless whether any cash changes hands in the transfer.

In addition to complaints about the application of the tax to circumstances that do not involve a sale, the Committee heard concerns raised by the Department of Human Resources and the Department of Public Education about the tax imposed on vehicles purchased by each Department or by local governmental units. The Department of Human Resources voiced concern about the tax imposed on vans equipped for the handicapped, and the Department of Public Instruction voiced concern about the tax imposed on public school buses and vehicles used in driver education programs in the public schools.

In response to these complaints and concerns, the Committee recommends that the following motor vehicles be exempt from the highway use tax:

1. Vehicles for which a new title is issued because the owner changed names.
2. Vehicles transferred to the Department of Human Resources to be equipped for use by the handicapped and then transferred to a handicapped person.
3. Public school buses.
4. Vehicles used in the driver education program of a public school.
5. Vehicles transferred as a result of the death of the former owner.

Currently, the vehicles described in items 1 and 5 are subject to only the minimum $40.00 tax. The other vehicles are subject to tax at the rate of 3%, with a $1,000 cap.

-----Election To Pay Highway Use Tax on October 1, 1989, Inventory
(Section 13 of Proposal 1)

The Highway Trust Fund legislation repealed the sales tax on motor vehicles effective October 1, 1989, imposed a titling tax on motor vehicles, and gave lessors and renters of motor vehicles an option of either paying the new 3% titling tax when purchasing a vehicle for lease or rental or waiving payment of the titling tax and collecting a tax on the lease or rental receipts. The law did not give lessors and renters an option of paying titling tax on vehicles owned on the effective date of the change.

Representatives of the leasing and rental industry brought this subject to the attention of the Revenue Laws Study Committee and pointed out that the failure to extend the same option to inventory owned on October 1 creates bookkeeping problems for lessors and renters and prevents them from having a uniform policy concerning the tax. In response to this, the Committee developed Section 13 of Proposal 1.

Section 12 allows lessors and renters of motor vehicles to elect to pay the new 3% highway use tax on motor vehicles owned by them on October 1, 1989, the effective date of the tax change. In doing so, it gives them the same option on their existing inventory that they have on vehicles purchased since October 1, 1989.

A lessor or renter who elects to pay the titling tax under the proposal will pay tax based on the retail value of the vehicle. The retail value for these motor vehicles is the wholesale book value of the vehicle as determined in accordance with schedules of value adopted by the Commissioner of Motor Vehicles. The retail value may be less than or greater than the lessor's or renter's book value of the vehicle, which is based on cost less depreciation.

-----Make Technical Corrections To Laws Affected By The Trust Fund Legislation
(Sections 12, 14, 15, 16, and 17 of Proposal 1)

The Committee identified several technical changes that need to be made as a result of the Trust Fund changes concerning taxes and fees. Sections 12, 14, 15, 16, and 17 of Proposal 1 make the necessary technical changes. The changes:

1. Make it clear that a motor vehicle sold for lease or rental is not exempt from the highway use tax under G.S. 105-187.6(a)(2). This clarification is necessary because the sales tax definition of "sale," which applies to the titling tax, includes lease or rental.
2. Delete an inaccurate reference in G.S. 105-187.6(b)(4) to the filing of a security interest in a motor vehicle with the Secretary of State. Security interests in most motor vehicles are perfected by filing with the Division of Motor Vehicles.
3. Allocate gas tax refunds made to the Cherokee Tribe between the Highway Fund and the Highway Trust Fund in accordance with the 75%/25% split for other refunds.
4. Delete unnecessary and inaccurate language in G.S. 20-57(b) concerning the fee imposed for issuing a copy of a registration card for a motor vehicle. G.S. 20-85 sets the fee at $10.00.
5. Delete unnecessary and inaccurate language in G.S. 20-85 concerning an exception to the fee schedule set in 20-85. G.S. 20-68 does not contain an exception to the fee schedule in 20-85 and has not since 1975.

Fiscal Report April 23, 1990
Legislative Proposal #1
(Highway Use Tax/Sales Tax Changes)

Legislative Proposal #1 incorporates a series of recommendations. The fiscal effect of each recommendation and whether it impacts the State General Fund and/or the Highway Trust Fund is listed below.

GENERAL FUND PROPOSALS

Recommendation	Fiscal Effect FY91
Reinstate Sales Tax on Mopeds & Tow Dollies	+ $ 27,785
Reinstate Sales Tax on Certain Motor Vehicle Bodies	+ $400,000
Establish a Uniform Long-Term Leasing Rate	- $ 375,000

HIGHWAY TRUST FUND PROPOSALS

Lower the Minimum Highway Use Tax from $40 to $20	- $ 11.8 million
Exempt Various Transfers of Motor Vehicles from the Highway Use Tax	
1. Transfers due to name changes	- $ 475,000
2. Vehicle transfers from the Department of Human Resources to the handicapped	- $ 10,000
3. Public school buses	- $1,275,000
4. Driver education vehicles in public schools	- $ 223,380
5. Transfers due to death	- $1,400,000
TOTAL	- $3,383,380

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S/H D

PROPOSAL 2 (89-LC-333)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Tax Fairness Changes. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO AMEND THE TAX FAIRNESS ACT OF 1989 TO PROVIDE TRANSITIONAL ADJUSTMENTS RELATING TO SUBCHAPTER S CORPORATIONS AND DEPRECIATION DEDUCTIONS, TO CORRECT AN ERROR THAT INADVERTENTLY DISALLOWED DEDUCTIONS FOR SOME MORTGAGE INTEREST PAYMENTS, AND TO PROVIDE ADDITIONAL TAX RELIEF FOR TAXPAYERS WITH DEPENDENTS WHO ARE PERMANENTLY AND TOTALLY DISABLED.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-131.4 reads as rewritten:

"**§ 105-131.4. Carryforwards; carrybacks; loss limitation.**

(a) Carryforwards and carrybacks to and from an S Corporation shall be restricted in the manner provided in section 1371(b) of the Code.

(b) The aggregate amount of losses or deductions of an S Corporation taken into account by a shareholder pursuant to G.S. 105-131.1(b) may not exceed the combined adjusted bases, determined in accordance with G.S. 105-131.3, of the shareholder in the stock and indebtedness of the S Corporation.

(c) Any loss or deduction that is disallowed for a taxable period pursuant to subsection (b) of this section shall be treated as incurred by the corporation in the succeeding taxable period with respect to that shareholder.

(d) (1) Any loss or deduction that is disallowed pursuant to subsection (b) of this section for the

corporation's last taxable period as an S Corporation shall be treated as incurred by the shareholder on the last day of any post-termination transition period.

(2) The aggregate amount of losses and deductions taken into account by a shareholder pursuant to subdivision (1) of this subsection may not exceed the adjusted basis of the shareholder in the stock of the corporation (determined in accordance with G.S. 105-131.3 at the close of the last day of any post-termination transition period and without regard to this subsection).

(e) Each shareholder's pro rata share of the reduction of an S Corporation's income because of the allowance of a carryforward loss to the S Corporation under this subsection shall be taken into account by the shareholder as a transitional adjustment under G.S. 105-134.7. Notwithstanding the provisions of subsection (a) of this section, an S Corporation that sustained a net economic loss in a taxable year beginning before January 1, 1989, may carry the loss forward to a taxable year beginning on or after January 1, 1989, and before July 1, 1990, and may deduct the loss in that year to the extent it could have carried forward and deducted the loss pursuant to G.S. 105-130.5(b)(4) and G.S. 105-130.8 if the S Corporation Income Tax Act had not become effective until taxable years beginning on or after July 1, 1990. Any loss carryforward allowed as a deduction by this subsection may not exceed the S Corporation's net income, as defined in the Code subject to the adjustments provided in G.S. 105-130.5 other than the adjustment provided in G.S. 105-130.5(b)(4), and is subject to the limitations provided in G.S. 105-131.4(b) and (d). Notwithstanding the provisions of G.S. 105-131.3, the basis of a shareholder in the stock of an S Corporation shall be adjusted for the shareholder's pro rata share of the carryforward loss allowed as a deduction to the S Corporation under this subsection. Notwithstanding the provisions of G.S. 105-131.6(c)(2), the accumulated adjustments account maintained for each resident shareholder shall be adjusted for the shareholder's pro rata share of the carryforward loss allowed as a deduction to the S Corporation under this subsection."

Sec. 2. G.S. 105-151.19 reads as rewritten:

"**§ 105-151.19. Credit for North Carolina dividends.**

There is allowed as a credit against the tax imposed by this Division an amount equal to six percent (6%) of the amount of dividends received by the taxpayer during the taxable year from

stock issued by a qualified corporation, up to a maximum credit of three hundred dollars ($300.00) per taxpayer for the taxable year. A corporation is a qualified corporation if fifty percent (50%) or more of the dividends from stock issued by the corporation would be deductible by a corporate shareholder for the taxable year under the provisions of G.S. 105-130.7(1), (2), (3), (3a), or (5) except that no credit shall be allowed for dividends ~~issued with respect to~~ deemed distributable from earnings for a taxable period during which the corporation is an S Corporation subject to the provisions of Division I-S of this Article.

This credit applies only with respect to dividends received while the taxpayer was a resident of this State. In the case of a married couple filing a joint return where both spouses received dividends during the taxable year, the three hundred dollar ($300.00) maximum applies separately to each spouse's dividends for a potential total credit of six hundred dollars ($600.00) for the couple. This credit may not exceed the amount of tax imposed by this Division for the taxable year reduced by the sum of all credits allowed under this Division, except payments of tax made by or on behalf of the taxpayer."

Sec. 3. Notwithstanding any other provision of law, with respect to dividends received by a taxpayer from an S Corporation and included in the taxpayer's North Carolina taxable income under Division II of Article 4 of Chapter 105 of the General Statutes for the taxpayer's 1989 taxable year, if (i) the dividends were distributed during the corporation's 1988 taxable year which began on or after January 2, 1988, and ended on or after January 1, 1989, or (ii) the dividends were distributed before October 1, 1989, then the three hundred dollar ($300.00) limitation in G.S. 105-151.19 shall not apply and any credit otherwise allowable with respect to these dividends shall be allowed without regard to the three hundred dollar ($300.00) limitation. No additional credit is allowed under G.S. 105-151.19 for dividends distributed on or after October 1, 1989, from an S Corporation during its 1989 taxable year, to the extent the taxpayer's total credit under G.S. 105-151.19 for the taxable year exceeds three hundred dollars ($300.00).

Sec. 4. G.S. 105-134.6(b) reads as rewritten:

"(b) Deductions. The following deductions from taxable income shall be made in calculating North Carolina taxable income, to the extent each item is included in gross income:

(1) Interest upon the obligations of (i) the United States or its possessions, (ii) this State or a

political subdivision of this State, or (iii) a nonprofit educational institution organized or chartered under the laws of this State.

(2) Interest upon obligations and gain from the disposition of obligations to the extent the interest or gain is exempt from tax under the laws of this State.

(3) Benefits received under Title II of the Social Security Act and amounts received from retirement annuities or pensions paid under the provisions of the Railroad Retirement Act of 1937.

(4) Any amount not to exceed one thousand five hundred dollars ($1,500) received by the taxpayer during the taxable year as compensation for the performance of duties as a member of the North Carolina organized militia, the national guard as defined in G.S. 127A-3.

(5) Refunds of State, local, and foreign income taxes included in the taxpayer's gross income.

(6) a. An amount, not to exceed four thousand dollars ($4,000), equal to the sum of the amount calculated in subparagraph b. plus the amount calculated in subparagraph c.

b. The amount calculated in this subparagraph is the amount received during the taxable year from one or more state, local, or federal government retirement plans.

c. The amount calculated in this subparagraph is the amount received during the taxable year from one or more retirement plans other than state, local, or federal government retirement plans, not to exceed a total of two thousand dollars ($2,000) in any taxable year.

d. In the case of a married couple filing a joint return where both spouses received retirement benefits during the taxable year, the maximum dollar amounts provided in this subdivision for various types of retirement benefits apply separately to each spouse's benefits.

(7) The amount of inheritance tax attributable to an item of income in respect of a decedent required to be included in gross income under the Code, adjusted as provided in G.S. 105-134.5, 105-134.6, and 105-134.7. The amount of inheritance tax

attributable to an item of income in respect of a decedent is (i) the amount by which the inheritance tax paid under Article 1 of this Chapter on property transferred to a beneficiary by a decedent exceeds the amount of inheritance tax that would have been payable by the beneficiary if the item of income in respect of a decedent had not been included in the property transferred to the beneficiary by the decedent, (ii) multiplied by a fraction, the numerator of which is the amount required to be included in gross income for the taxable year under the Code, adjusted as provided in G.S. 105-134.5, 105-134.6, and 105-134.7, and the denominator of which is the total amount of income in respect of a decedent transferred to the beneficiary by the decedent. For an estate or trust, the deduction allowed by this subdivision shall be computed by excluding from the gross income of the estate or trust the portion, if any, of the items of income in respect of a decedent that are properly paid, credited, or to be distributed to the beneficiaries during the taxable year.

(8) The amount by which the taxpayer's mortgage interest deduction under the Code was reduced pursuant to section 163(g) of the Code."

Sec. 5. G.S. 105-134.7(a) reads as rewritten:

"(a) The following adjustments to taxable income shall be made in calculating North Carolina taxable income:

(1) Amounts that were included in the basis of property under federal tax law but not under State tax law before January 1, 1989, shall be added to taxable income in the year the taxpayer disposes of the property.

(2) Amounts that were included in the basis of property under State tax law but not under federal tax law before January 1, 1989, shall be deducted from taxable income in the year the taxpayer disposes of the property.

(3) Amounts that were recognized as income under federal law but not under State law due to a taxpayer's use of the installment method set out in G.S. 105-142(f) prior to January 1, 1989, shall be added to taxable income in the taxpayer's first

taxable year beginning on or after January 1, 1989. Amounts that were recognized as income under State law but not under federal law due to a taxpayer's use of a different installment method prior to January 1, 1989, shall be deducted from taxable income in the taxpayer's first taxable year beginning on or after January 1, 1989.

(4) Losses in the nature of net economic losses sustained in any or all of the five taxable years preceding the taxpayer's first taxable year beginning on or after January 1, 1989, arising from business transactions, business capital, or business property, may be deducted from taxable income subject to the limitations contained in former G.S. 105-147(9)a., c., and d. (repealed).

(5) The amount of any net operating loss for a taxable year beginning on or after January 1, 1989, carried back to a taxable year beginning before January 1, 1989, pursuant to section 172 of the Code may be deducted from taxable income in the taxable year following the taxable year for which the loss occurred.

(6) A loss or deduction that was incurred or paid and deducted from State taxable income in a taxable year beginning before January 1, 1989, and is carried forward and deducted in a taxable year beginning on or after January 1, 1989, under the Code shall be added to taxable income.

(7) The transitional adjustments provided in Division I-S of this Article shall be made with respect to a shareholder's pro rata share of S Corporation income.

<u>(8) Notwithstanding the provisions of subdivision (2) of this subsection, in the case of property that the taxpayer elected to expense under section 179 of the Code for a taxable year beginning on or before December 31, 1988, the taxpayer shall deduct an allowance for depreciation equal to the amount that would have been allowed under former G.S. 105-147(12)(repealed) each year until the amount deductible for depreciation is equal to the amount deducted under section 179 of the Code. Amounts deductible under this subdivision may not be deducted from taxable income under subdivision (2)</u>

of this subsection in the year the taxpayer disposes of the property."

Sec. 6. G.S. 105-151.18 reads as rewritten:

"**§ 105-151.18. Credit for the disabled.**

(a) Disabled Taxpayer. A ~~person~~ taxpayer who (i) is retired on disability, (ii) at the time of retirement, was permanently and totally disabled, ~~disabled as defined in section 22 of the Code,~~ and (iii) claims a federal income tax credit under section 22 of the Code for the taxable year, is allowed as a credit against the tax imposed by this Division an amount equal to one-third of the amount of the federal income tax credit for which ~~he~~ the taxpayer is eligible under section 22 of the Code.

(b) Disabled Dependent. If a dependent for whom a taxpayer is allowed an exemption under the Code is permanently and totally disabled, the taxpayer is allowed a credit against the tax imposed by this Division. In order to claim the credit allowed by this subsection, the taxpayer must attach to the tax return on which the credit is claimed a statement from a physician or local health department certifying that the dependent for whom the credit is claimed is permanently and totally disabled, as defined in this section. The amount of the credit allowed shall be determined as follows: For a taxpayer whose North Carolina adjusted gross income does not exceed the appropriate income amount provided in the table below, based on the taxpayer's filing status, the credit allowed is the appropriate initial credit provided in the table below. For a taxpayer whose North Carolina adjusted gross income does exceed the appropriate income amount, the credit allowed is the appropriate initial credit reduced by five dollars ($5.00) for every one thousand dollars ($1,000) by which the taxpayer's North Carolina adjusted gross income exceeds the appropriate income amount.

Filing Status	Initial Credit	Income Amount
Head of Household	$ 80.00	$16,000
Surviving Spouse or Joint Return	$100.00	$20,000
Married Filing Separately	$ 50.00	$10,000

(c) Definitions. The following definitions apply in this section:

(1) North Carolina Adjusted Gross Income. Adjusted gross income, as determined under the Code, adjusted as provided in G.S. 105-134.6 and G.S. 104-134.7.

(2) Permanently and Totally Disabled. Unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.

(d) Limitations. A nonresident or part-year resident who claims the credit allowed by this section shall reduce the amount of the credit by multiplying it by the fraction calculated under G.S. 105-134.5(b) or (c), as appropriate. The credit allowed under this section may not exceed the amount of tax imposed by this Division for the taxable year reduced by the sum of all credits allowed under this Division, except payments of tax made by or on behalf of the taxpayer."

Sec. 7. Section 1 of this act is effective retroactively for taxable years beginning on or after January 1, 1989, and shall expire for taxable years beginning on or after July 1, 1990. Section 6 of this act is effective for taxable years beginning on or after January 1, 1990. The remainder of this act is effective retroactively for taxable years beginning on or after January 1, 1989.

Explanation of Proposal 2

On August 7, 1989, the General Assembly enacted a sweeping reform of the State's personal income tax system effective for taxable years beginning on or after January 1, 1989. This legislation, known as the Tax Fairness Act of 1989, revised the Individual Income Tax Act by using federal taxable income as the starting point for determining an individual's North Carolina taxable income. The Tax Fairness Act is by far the most comprehensive revision of the Individual Income Tax Act since it was enacted in its modern form in the 1930s. The new legislation affects virtually every step required in calculating an individual's State income tax and indirectly affects numerous related tax statutes.

The Tax Fairness Act, originally introduced in the 1987 General Assembly, was studied and debated by the 1987 General Assembly and by two legislative committees between the 1987 and 1989 Sessions, the Revenue Laws Study Committee and the Tax Fairness Study Commission. In 1989, the legislation was again studied, debated, and revised by the General Assembly. The changes made by the Tax Fairness Act were so extensive that, despite the scrutiny it received from the General Assembly, the Department of Revenue, tax professionals, and the public, there were still some tax consequences of the rewrite that were not discovered until after its enactment. The Revenue Laws Study Committee was directed to study the impact of the tax law changes enacted in 1989. The Department of Revenue, the North Carolina Bar Association, the North Carolina Association of Certified Public Accountants, legislators, and members of the public all contacted the committee with suggestions for improvements to the new law to better enable it to achieve its goals of fairness, simplicity, and efficiency. A number of these suggestions were adopted and included in Legislative Proposal 2.

-----Subchapter S Corporations

Since 1958, federal income tax law has allowed certain corporations having fewer than 35 shareholders to elect to be taxed as "Subchapter S Corporations." Under the S Corporation option, items of income and loss are not taxable to the corporation but are passed through to the shareholders in the same way items of income and loss of a partnership are taxed to the individual partners. In 1988, the General Assembly

enacted legislation to provide that the State would allow S Corporation tax treatment for federal S Corporations. This legislation was to become effective for taxable years beginning on or after July 1, 1990. Then, in 1989, the Tax Fairness Act incorporated the 1988 S Corporation legislation into its provisions with a new effective date of January 1, 1989. After the end of the 1989 Session, members of the Revenue Laws Study Commission and other legislators were contacted about tax problems caused by the acceleration of the effective date of the S Corporation legislation by the Tax Fairness Act of 1989. The January 1, 1989, effective date set by the Tax Fairness Act, ratified in August 1989, created unanticipated tax consequences for actions that were taken before the act was ratified, and eliminated the planning period allowed by the original July 1, 1990, effective date of the S Corporation law.

One problem of particular concern is the disallowance of carryovers of pre-1989 losses. The original S Corporation law provided that net economic losses sustained before the effective date of the act could not be carried forward to offset income in later tax years. This provision was agreed upon by all interested parties in 1988; the impact of the provision on taxpayers was mitigated somewhat by the delayed effective date, which gave taxpayers time to plan for the change. This planning period was lost when the Tax Fairness Act changed the effective date to January 1, 1989, causing unanticipated tax increases for numerous small businesses in North Carolina, including many farmers.

In order to provide relief for taxpayers in this situation, the Revenue Laws Study Committee adopted Section 1 of Legislative Proposal 2, which would restore to taxpayers the delayed effective date for the disallowance of loss carryforwards. Pre-1989 net economic losses could be carried forward by the corporation and used to offset the corporation's income in 1989 and 1990, and this offset would be passed through to the shareholders in those tax years. The proposal would be retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns for that year.

The Revenue Laws Study Committee also studied a similar problem, a one-time "double taxation" of certain distributions made by S Corporations in 1989. For an S Corporation that does not use the calendar year as its tax year, certain earnings for the corporation's 1988 tax year were taxed at the corporate level under the old law, because the corporation's tax year started before 1989, and also at the individual level under the new law, because the earnings, distributed as dividends, were included in the shareholder's 1989 taxable income. For calendar year corporations that made distributions of 1988 earnings in early 1989, the earnings were taxed at the corporate

level under the old law and then distributed as dividends when the then current law provided that the shareholder would receive a full dividend deduction. After the distribution was made, the new law made these dividends taxable with only a limited tax credit, subject to a $300 maximum, allowed. The change in the law thus subjected these dividends to unanticipated "double taxation."

In developing a proposal to provide relief in this situation, the Revenue Laws Study Committee considered fairness, ease of administration, and fiscal impact. The proposal selected by the committee, Sections 2 and 3 of Legislative Proposal 2, provides a full tax credit, without any maximum, for distributions from pre-1989 earnings made before October 1, 1989, or made by a fiscal year corporation during its 1988 tax year. The use of a credit rather than a deduction makes the one-time relief easier for the Department of Revenue to administer and easier for taxpayers to comply with. The proposal balances fiscal and fairness considerations by retaining the 6% credit rate. The proposal would be retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns.

-----Mortgage Interest Deduction

Section 25 of the Internal Revenue Code provides that first-time home buyers who do not exceed certain income and sales price levels may obtain a Mortgage Credit Certificate (MCC). The MCC enables the homeowner to take a federal tax credit of up to 25% of his or her annual mortgage interest payments. The portion of the interest that is taken as a credit may not also be taken as a deduction in calculating federal taxable income. North Carolina does not allow a tax credit for MCC holders; it does use federal taxable income as the starting point in calculating North Carolina taxable income. As a result, an MCC holder whose mortgage interest deduction under the Code was reduced by the amount of the federal credit will not be able to deduct the full amount of the mortgage interest for North Carolina tax purposes. When it enacted the Tax Fairness Act of 1989, the General Assembly did not intend to disallow full deduction of interest for MCC holders, who tend to be lower income taxpayers; the disallowance occurred as a result of an oversight. In order to correct this oversight, the Revenue Laws Study Committee adopted Section 4 of Legislative Proposal 2, which would allow a taxpayer to deduct from taxable income the amount of his or her mortgage interest that was not deducted under the Code due to the taxpayer's use of the mortgage interest credit. The proposal would be retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns for that year.

-----Depreciation Transition Adjustment

In rewriting the Individual Income Tax Act to use federal taxable income as the starting point for calculating a taxpayer's North Carolina income tax, the Tax Fairness Act of 1989 provided a number of transitional adjustments to allow taxpayers to take into account pre-1989 differences between the State income tax law and the Internal Revenue Code. Where these differences resulted in a different basis in property for State tax purposes and federal tax purposes, the new law provided that the taxpayer would take the difference into account when the property was disposed of. For example, where the property's basis was higher for federal income tax purposes than for State income tax purposes, the difference would be recognized as additional gain when the taxpayer disposed of the property. In the same way, where the basis was higher for State tax purposes, less gain would be recognized under State tax law when the taxpayer disposed of the property.

The Revenue Laws Study Committee was informed that some taxpayers were displeased with the latter transitional adjustment in the case of property that had been expensed under Section 179 of the Code before the 1989 tax year. Section 179 allows a taxpayer to elect to treat the cost of certain property as an expense that is not chargeable to capital account and may be deducted in the year the property is placed in service. Before 1989, North Carolina did not allow such an election; rather than deducting the cost of the property in the year it was placed in service, the taxpayer was allowed depreciation deductions under former G.S. 105-147(12), spread out over a number of years. For property that was expensed under Section 179 before 1989 and was being depreciated for State tax purposes, the Tax Fairness Act provided that the State depreciation deductions would be discontinued beginning in 1989 and the difference in basis for State and federal tax purposes would result in lower State taxable income in the year the property was disposed of. Thus, the taxpayer was required to postpone the benefit of the depreciation deductions that would have been allowed in 1989 and the years following under the prior law.

The Revenue Laws Study Committee adopted Section 5 of Legislative Proposal 2 to address this situation. Section 5 would require a taxpayer who expensed property before 1989 to take the depreciation deductions that would have been allowable under the former State law. For all other situations that result in a difference in basis, the difference would continue to be taken into account when the taxpayer disposes of the property.

-----Disabled Dependents Tax Credit

Until the 1989 tax year, North Carolina provided an additional $1,100 personal exemption for taxpayers and some dependents with certain physical conditions. Families with severely retarded dependents were eligible for a $2,200 personal exemption. Before the repeal of these exemptions in 1989, they covered 13 different diseases and physical conditions. Anyone who had one of the named conditions received a tax benefit, regardless whether the impact of the condition was disabling. Many other debilitating diseases and disabling conditions were not, however, named in the law, so persons subject to these conditions did not receive a similar tax benefit.

Because these personal exemptions were deducted from gross income, they had a regressive tax impact. That is, persons with higher incomes received a greater benefit from the exemptions than persons with lower incomes. For example, a low-income person who was in the 3% tax bracket would receive a $33.00 reduction in tax by claiming a $1,100 personal exemption; a higher-income person who was in the top tax bracket (7%) would receive a $77.00 reduction in tax by claiming the same personal exemption.

These personal exemptions were repealed by the Tax Fairness Act of 1989. By adopting the federal personal exemption and standard deduction amounts, the law should reduce or eliminate income taxes for the State's poorest citizens and reduce taxes for most lower-to-middle income families. Higher income taxpayers should experience a small percentage increase in tax. In enacting the new law, it was felt that most of the persons who had previously benefitted from the special tax breaks based on certain diseases and disabilities would actually pay less tax under the new law, and thus would not be hurt by the elimination of these exemptions.

The Tax Fairness Act of 1989 also adopts the federal rules that allow additional standard deduction amounts for taxpayers who are 65 or older and/or blind. The new law adopts the federal credit for the disabled, which shelters a low-income taxpayer's disability income from tax. The law also expands the amount of the dependent care credit that applies to dependents who are mentally or physically unable to care for themselves.

In reviewing these tax benefits, the Revenue Laws Study Committee decided there was a need to provide additional tax relief for taxpayers who have dependents who are disabled. The Committee adopted Section 6 of Legislative Proposal 2, which would allow a new tax credit, avoiding the regressive effect of a deduction which benefits

persons with higher income more than persons with lower income. The credit would apply equally to all who are disabled, rather than singling out certain physical conditions for favorable treatment while providing no relief for others. The maximum credit allowed would be $100.00 for a surviving spouse or couple filing a joint return: the amount of the credit would decrease as the taxpayer's income increased over $20,000 and would phase out completely for taxpayers with income above $40,000. For a head of household, the maximum credit would be $80.00, phased out for taxpayers with income between $16,000 and $32,000. Thus, the proposal is crafted to provide the greatest benefit to the neediest families with disabled dependents.

Overview of Bill:
The 1989 General Assembly overhauled the state personal income tax for the first time since its inception in 1921 by tying the state tax calculation to federal taxable income and applying 6% and 7% rate brackets. The new act became effective for the 1989 tax year.

Due to the late ratification date of the new act and the 1989 effective date, concern has been expressed by many taxpayers about the short lead time in adjusting their financial decisions to the new law. In many cases, the new law created unanticipated tax consequences for act taken in 1989 before the act was ratified. In addition, there are some technical language changes needed to clarify the new tax code.

S CORPORATION CHANGES

Background Information
Since 1958, federal tax law has allowed certain closely-held corporations to be taxed in a form similar to a partnership. Under current rules, corporations with less than 35 owners are exempt from the corporate income tax with items of income and loss being passed through each year to the shareholders.

During the 1988 session, the General Assembly allowed S Corporation filing for state purposes, effective for tax years beginning on or after July 1, 1990 (January 1, 1991 for calendar years corporations). The enactment of SB 51 accelerated the effective date of S Corporation filing to the 1989 tax year.

Explanation of Changes

(1) Regular corporations are allowed to carry forward net economic losses for up to five years. The language in the 1988 S Corporation act (carried forward to SB 51) did not allow losses at the corporate level prior to the conversion to S Corporation status to be used to offset income under the new system. However, the 2 1/2-3 year planning period under the 1988 allowed affected taxpayers time to plan for and adjust to the change. The acceleration of S Corp filing under SB 51 eliminated this tax planning period.

Proposal 2 amends SB 51 by restoring the delayed effective date of S Corp tax filing with respect to the provision that disallows loss carryforwards. Thus, pre-1989 net economic losses can be carried forward and used to offset the corporation's income in 1989 and 1990 and this offset would be passed through to individual shareholders. The shareholders could capture this offset for the 1989 tax year by filing an amended return.

(2) A case of double taxation can occur under the new law in the situation of certain distributions (such as dividends) made by an S Corp during the 1989 calendar year. For an S Corp that does not use the calendar year as its fiscal year, earnings for the corporation's 1988 fiscal year that were distributed during its 1989 fiscal year were taxed at the corporate level for 1988 and then as dividends to shareholders for the 1989 calendar year. Under prior tax law double taxation could be avoided in many cases through the $15,000 deduction for N.C. dividends (equivalent to a $1,050 tax benefit). SB 51 contains a smaller offset for many taxpayers ($300 tax credit).

Proposal 2 allows taxpayers an unlimited tax credit for distributions from pre-1989 earnings made before October 1, 1989, or made by a fiscal year corporation during the 1988 calendar year. The taxpayer could capture this relief for the 1989 tax year by filing an amended return.

Effective Date:
Tax years beginning on or after January 1, 1989.

Fiscal Effect:
There is little good data on the amount of loss carryforwards that exist in North Carolina or the impact of the dividend credit. Using IRS data on federal S Corporation losses and the number of phone calls received by the Department of Revenue on this issue suggests the enactment of these portions of the bill could reduce General Fund tax revenue by as much as $2 million for the 1989 tax year refund. The impact on 1990-91 from the loss carryforward provision may be as much as $1 million. There would be no impact in future years.

MORTGAGE CREDIT CERTIFICATE

Background Information:
In 1984 the U.S. Congress included in its tax adjustment package a proposal to allow states to create a mortgage certificate credit program (MCC). The N.C. Housing Finance Agency (NCHFA) began offering the program in 1987 through 111 lending institutions.

Under the MCC qualified first-time home buyers may take 15% or 25% of their mortgage interest costs as federal income tax credit instead of a deduction. The credit allows the homeowner a significant increase in federal tax relief for home ownership. For example, a married couple with $25,000 or gross income and $4,000 of mortgage interest would receive $1,450 of tax relief (assuming a 25% credit) under the special credit option versus $600 under the straight deduction.

The North Carolina income tax base uses federal taxable income as a starting point. Since the federal itemized deduction for mortgage costs is reduced by the credit base. North Carolinians using the federal credit are not able to offset the full amount of their interest costs.

Explanation of Change:
Allows North Carolina taxpayers receiving the federal mortgage certificate credit to deduct from their state taxable income the amount of the federal credit base. thereby ensuring that 100% of their mortgage costs are deductible for state purposes.

Effective Date:
Tax years beginning on or after January 1, 1989.

Fiscal Effect:
Would reduce General Fund tax revenue by $345.000 for the 1990-91 fiscal year. In addition. there could be $260.000-345.000 of one-time refunds in 1990-91 for the 1989 tax year.

DISABILITY TAX CREDIT

Background Information
Prior to SB 51 taxpayers and/or dependents were allowed an additional personal income tax exemption of $1.100 ($2.200 in one case) for certain physical conditions (regardless of whether the condition led to the person being disabled). During each legislative session a couple of new conditions were made eligible for the exemption. In 1988. a total of 13 special exemptions were covered. No other state allowed such treatment.

SB 51 allows a state tax credit of one-third the federal credit for taxpayers who receive disability income. The credit phases down as the taxpayer's income rises. The new law also allows a higher standard deduction for taxpayers who are blind. there is no special relief for disabled dependents.

Explanation of Change
Allows taxpayers to take a tax credit for disabled dependents at the following base amount:

		Adjusted Gross Income	
	Maximum Credit	At Beginning of Phase-Down	At End of Phase-Down
Head-Of-Household	$80	$16,000	$32.000
Married. filing jointly	100	20,000	40.000
Married. filing separately	50	10.000	20.000

Effective Date
1990 tax year.

Fiscal Effect
Under prior law the additional exemptions provided $33 of relief for the lowest income taxpayers and $77 for taxpayers in the highest bracket. The total cost of these special exemptions was approximately $4 million.

The $4 million cost of the prior exemptions would need to be adjusted for the following items to determine the cost of the proposed credit:

(1) The broad-based nature of the credit means that more disabilities would be covered
(2) The credit applies to dependents only, while the exemption applied to dependents *and* taxpayers in some cases
(3) Many low-income taxpayers were taken off the tax rolls under SB 51
(4) The relief per taxpayer under the credit is generally greater than under the prior exemption but the income phase-out will limit the credit to low- and middle-income taxpayers.

SECTION 179 PROPERTY

Background Explanation:
Under Section 179 of the Internal Revenue Code a taxpayer is allowed to expense (fully deduct in year of purchase) up to $10.000 of personal property used in a trade or business. The basis (purchase price and related costs) of personal property above this amount must be depreciated over a 7 year period. The depreciation is then "recaptured" when the property is disposed of.

Because North Carolina tax law has never allowed the Sec. 179 expensing, the basis of such property had been different for federal and state purposes. The transitional language in SB 51 would have adjusted the basis in the year in which the property was disposed of. The effect is to eliminate the annual depreciation of the property and to make a one-time adjustment when the property is sold.

Explanation of Provision:
Amends the 1989 transition language to allow a taxpayer who took the Sec. 179 election for a tax year beginning before January 1. 1989 to continue depreciating the property until the total depreciation equals the amount the taxpayer originally expensed for federal tax purposes.

Effective Date:
Tax years beginning on or after January 1. 1989.

Fiscal Effect:
The one-time impact on General Fund tax revenue for 1989 tax year refunds will be $2.0-2.5 million, depending on how many eligible taxpayers actually file for refunds. The on-going cash-flow impact on each year's tax collections is a reduction of $2.6 million, beginning with the 1990-91 fiscal year.

Over the long-run there is no net impact as the continuance of the depreciation deduction will mean a larger depreciation recapture when the property is disposed of.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S/H D

PROPOSAL 3 (89-LCX-316)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Adopt 1990 Code and Index. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS AND TO ADOPT THE FEDERAL STANDARD DEDUCTION AND PERSONAL EXEMPTION AMOUNTS FOR 1990.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-134.1(1) reads as rewritten:

"(1) Code. The Internal Revenue Code as enacted as of January 1, ~~1989,~~ 1990, including any provisions enacted as of that date which become effective either before or after that ~~date, but not including sections 63(c)(4) and 151(d)(3).~~ date."

Sec. 2. G.S. 105-134.6(c) reads as rewritten:

"(c) Additions. The following additions to taxable income shall be made in calculating North Carolina taxable income, to the extent each item is not included in gross income:

(1) Interest upon the obligations of states, other than this State, and their political subdivisions.

(2) Any amount allowed as a deduction from gross income under the Code that is taxed under the Code by a separate tax other than the tax imposed in section 1 of the Code. The Secretary shall report to the 1991 General Assembly all provisions under the Code for taxing certain amounts separately and shall

recommend whether those amounts should be taxed separately under this Division or should be added to taxable income in calculating North Carolina taxable income.

(3) Any amount deducted from gross income under section 164 of the Code as State, local, or foreign income tax to the extent that the taxpayer's total itemized deductions deducted under the Code for the taxable year exceed the standard deduction allowable to the taxpayer under the Code reduced by the amount by which the taxpayer's allowable standard deduction has been increased under section 63(c)(4) of the ~~Code.~~ Code for taxable years beginning on or after January 1, 1991.

(4) The amount by which the taxpayer's standard deduction has been increased under section 63(c)(4) of the Code for taxable years beginning on or after January 1, 1991, and the amount by which the taxpayer's personal exemptions have been increased under section 151(d)(3) of the ~~Code.~~ Code for taxable years beginning on or after January 1, 1991."

Sec. 3. G.S. 105-134.2 reads as rewritten:

"**§ 105-134.2. Individual income tax imposed.**

(a) A tax is imposed upon the North Carolina taxable income of every individual. The tax shall be levied, collected, and paid annually and shall be computed at the following percentages of the taxpayer's North Carolina taxable income.

(1) For married individuals who file a joint return under G.S. 105-152.1 and for surviving spouses, as defined in section 2(a) of the Code:

On the North Carolina taxable income up to ~~twenty-one thousand two hundred fifty dollars ($21,250),~~ fourteen thousand five hundred dollars ($14,500), six percent (6%); and

On the excess over ~~twenty-one thousand two hundred fifty dollars ($21,250),~~ fourteen thousand five hundred dollars ($14,500), seven percent (7%).

(2) For heads of households, as defined in section 2(b) of the Code:

On the North Carolina taxable income up to ~~seventeen thousand dollars ($17,000),~~ eleven thousand six hundred dollars ($11,600), six percent (6%); and

On the excess over ~~seventeen thousand dollars ($17,000),~~ eleven thousand six hundred dollars ($11,600), seven percent (7%).

(3) For unmarried individuals other than surviving spouses and heads of households:

On the North Carolina taxable income up to ~~twelve thousand seven hundred fifty dollars ($12,750),~~ eight thousand seven hundred dollars ($8,700), six percent (6%); and

On the excess over ~~twelve thousand seven hundred fifty dollars ($12,750),~~ eight thousand seven hundred dollars ($8,700), seven percent (7%).

(4) For married individuals who do not file a joint return under G.S. 105-152.1:

On the North Carolina taxable income up to ~~ten thousand six hundred twenty-five dollars ($10,625),~~ seven thousand two hundred fifty dollars ($7,250), six percent (6%); and

On the excess over ~~ten thousand six hundred twenty-five dollars ($10,625),~~ seven thousand two hundred fifty dollars ($7,250), seven percent (7%)."

Sec. 4. G.S. 105-2.1 reads as rewritten:

"§ 105-2.1. Internal Revenue Code definition.

As used in this Article, the term 'Code' means the Internal Revenue Code as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date."

Sec. 5. G.S. 105-114 reads as rewritten:

"§ 105-114. Nature of taxes; definitions.

(a) Nature of Taxes. The taxes levied in this Article upon persons and partnerships are for the privilege of engaging in business or doing the act named. The taxes levied in this Article upon corporations are privilege or excise taxes levied upon:

(1) Corporations organized under the laws of this State for the existence of the corporate rights and privileges granted by their charters, and the enjoyment, under the protection of the laws of this State, of the powers, rights, privileges and immunities derived from the State by the form of such existence; and

(2) Corporations not organized under the laws of this State for doing business in this State and for the

benefit and protection which such corporations receive from the government and laws of this State in doing business in this State.

If the corporation is organized under the laws of this State, the payment of the taxes levied by this Article shall be a condition precedent to the right to continue in such form of organization; and if the corporation is not organized under the laws of this State, payment of these taxes shall be a condition precedent to the right to continue to engage in doing business in this State. The taxes levied in this Article or schedule shall be for the fiscal year of the State in which the taxes become due; except that the taxes levied in G.S. 105-122 and G.S. 105-123 shall be for the income year of the corporation in which the taxes become due.

(b) Definitions. The following definitions apply in this Article:

(1) ~~As used in this Article, the~~ The term 'Code' means the Internal Revenue Code as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date.

(2) The term 'corporation' ~~as used in this Article~~ shall, unless the context clearly requires another interpretation, mean and include not only corporations but also associations or joint-stock companies and every other form of organization for pecuniary gain, having capital stock represented by shares, whether with or without par value, and having privileges not possessed by individuals or partnerships; and whether organized under, or without, statutory authority. The term 'corporation' ~~as used in this Article~~ shall also mean and include any electric membership corporation organized under Chapter 117, and any electric membership corporation, whether or not organized under the laws of this State, doing business within the State.

(3) The ~~When the~~ term 'doing business' ~~is used in this Article, it~~ shall mean and include each and every act, power or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges acquired by the nature of such organizations whether the form of existence be

corporate, associate, joint-stock company or common-law trust.

~~If the corporation is organized under the laws of this State, the payment of the taxes levied by this Article shall be a condition precedent to the right to continue in such form of organization; and if the corporation is not organized under the laws of this State, payment of said taxes shall be a condition precedent to the right to continue to engage in doing business in this State. The taxes levied in this Article or schedule shall be for the fiscal year of the State in which said taxes become due; except, that the taxes levied in G.S. 105-122 and G.S. 105-123 shall be for the income year of the corporation in which such taxes become due. For purposes of this Article, the words~~

(4) The term 'income year' shall mean an income year as defined in G.S. 105-130.2(5)."

Sec. 6. G.S. 105-130.2(1) reads as rewritten:

"(1) 'Code' means the Internal Revenue Code as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date."

Sec. 7. G.S. 105-131(b)(1) reads as rewritten:

"(1) 'Code' means the Internal Revenue Code ~~of 1986,~~ as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date."

Sec. 8. G.S. 105-163.1(11) reads as rewritten:

"(11) 'Code' means the Internal Revenue Code as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date."

Sec. 9. G.S. 105-212(f) reads as rewritten:

"(f) As used in this section, the term 'Code' means the Internal Revenue Code as enacted as of ~~January 1, 1989,~~ January 1, 1990, and includes any provisions enacted as of that date which become effective either before or after that date."

Sec. 10. This act is effective for taxable years beginning on or after January 1, 1990.

Explanation of Proposal 3

Legislative Proposal 3 rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1989, to January 1, 1990. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The inheritance tax, franchise tax, and intangibles tax also determine some exemptions based on the provisions of the Code.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law recently and the likelihood of continued changes, the State may not want to adopt automatically federal changes, particularly when these changes result in large revenue losses. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, § 2(1) of the Constitution provides in pertinent part that the "power of taxation... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would... be invalidated as an unconstitutional delegation of legislative power."

Each year, in deciding whether the Internal Revenue Code reference should be updated, the Revenue Laws Study Committee considers the changes that have been made to the Code in the past year. The Revenue Laws Study Committee learned this year that the 1989 Code changes will have only a negligible impact on the State corporate income tax. There were a number of Code changes, however, that will affect the State individual income tax; these changes are outlined in Appendix E. The most significant of these changes, allowance of a deduction for self-employment taxes, will reduce individual income tax revenues.

Legislative Proposal 3 also adopts a provision of the Code that increased the personal exemption and standard deduction amounts for the 1990 tax year. The Tax Fairness Act of 1989 established federal taxable income, as determined under the Code, as the starting point for North Carolina taxable income. The federal personal exemption and standard deduction amounts are subtracted as part of the calculation of federal taxable income. Under the Code, these federal amounts are increased automatically each year based on increases in the cost of living due to inflation. Automatically indexing the exemption and deduction amounts in this way assures that taxpayers pay more taxes if they have real increases in income but not if their income increases only at the same rate as inflation. The Tax Fairness Act of 1989 did not adopt the federal indexing based on inflation; State income tax law uses the federal exemption and deduction amounts set by the Code without regard to automatic increases based on inflation. As a result, a North Carolina taxpayer must add to North Carolina taxable income the difference between the federal base amounts and the indexed amounts. In addition, a taxpayer whose income increases by less than the amount by which the cost of living increased will pay higher taxes.

The Revenue Laws Study Committee investigated whether North Carolina should adopt inflation indexing of the personal exemption and standard deduction amounts. Adopting indexing causes State income tax revenues to grow more slowly each year than they otherwise would. On the other hand, adopting indexing makes it easier for North Carolina citizens to calculate their taxes and protects them from some of the negative effects of inflation. After balancing these considerations, the Committee decided to recommend adoption of the federally indexed amounts for the current tax year, 1990. Whether to adopt inflation indexing for later years can be decided each year based on considerations relevant to that year. The Committee also decided that the update of the personal exemption and standard deduction amounts should be combined with the update of the Code reference, and that the income tax rate

thresholds should be adjusted to make the entire package revenue-neutral. The change in tax thresholds, provided in Section 3 of Legislative Proposal 3, will apply the 7% rate to more of each taxpayer's taxable income, thereby generating revenue to offset the decrease in taxes resulting from adoption of larger personal exemptions and standard deductions as well as the new deduction for self-employment taxes.

PROPOSAL 3

FISCAL REPORT
FISCAL RESEARCH DIVISION
APRIL 23, 1990

Background Information:
Under the Tax Fairness Act of 1989 (SB 51), the state personal income tax was completely overhauled. The new state tax uses federal taxable income as the starting point and two tax rates (6% and 7%). The new law conformed to the Internal Revenue Code as of January 1, 1989.

By using federal taxable income as the starting point in the state calculation, the federal personal exemption level of $2,000 per person was adopted. The conformity language was written so that the 1988 standard deduction levels ($5,000 for married couple filing jointly) were used.

Under federal law, the personal exemption and standard deduction amounts are indexed annually to the rise in the Consumer Price Index.

Explanation of Proposal:

(1) Updates state conformity to the Internal Revenue Code from January 1, 1989 to January 1, 1990. The effect of updating conformity is to pick up the handful of federal tax changes from last year, to increase personal exemptions from $2,000 to $2,050, and to increase the standard deductions by 8-9% (from $5,000 for a married couple filing jointly to $5,450).

(2) To offset the impact of the higher personal exemptions and standard deduction amounts, the income threshold at which the 7% rate schedule applies is lowered as follows:

	Tax Rate	Current Brackets	Proposed Brackets
Married filing jointly, surviving spouse	6%	$1-$21,250	$1-$14,500
	7%	$21,251 & over	$14,501 & over
Head-of-household	6%	$1-$17,000	$1-$11,600
	7%	$17,001 & over	$11,601 & over
Single person	6%	$1-$12,750	$1-$8,700
	7%	$12,750 & over	$8,701 & over
Married filing separately	6%	$1-$10,625	$1-$7,250
	7%	$10,626 & over	$7,251 & over

Effective Date:
Upon ratification.

Fiscal Effect:
The tax rate schedule was adjusted to threshold levels that would lead to no annual change in General Fund tax revenue, based on the best data available.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S OR H D

PROPOSAL 4 (90-RB-102)

THIS IS A DRAFT AND NOT READY FOR INTRODUCTION

Short Title: Property Tax Appeals/Technical Changes. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE TIME ALLOWED FOR FILING CERTAIN PROPERTY TAX APPEALS AND TO MAKE TECHNICAL CORRECTIONS TO THE PROPERTY TAX STATUTES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-290(e) reads as rewritten:

"(e) Time Limits for Appeals. ~~A notice of appeal from an order of a board of equalization and review shall be filed with the Property Tax Commission within 30 days after the board of equalization and review has mailed a notice of its decision to the property owner. A notice of appeal from an order of a board of commissioners concerning the listing, appraisal, or assessment of property shall be filed with the Property Tax Commission within 30 days after the board of county commissioners enters the order.~~ <u>A notice of appeal from an order of a board of county commissioners, other than an order adopting a uniform schedule of values, or from a board of equalization and review shall be filed with the Property Tax Commission within 30 days after the date the board mailed a notice of its decision to the property owner. A notice of appeal from an order adopting a schedule of values shall be filed within the time set in subsection (c).</u>"

Sec. 2. G.S. 105-290(g) reads as rewritten:

"(g) What Constitutes Filing. ~~A notice of appeal is considered to be filed with the Property Tax Commission when it is received in the office of the Commission.~~ A notice of appeal submitted to the Property Tax Commission by a means other than United States mail is considered to be filed on the date it is received in the office of the Commission. A notice of appeal submitted to the Property Tax Commission by United States mail is considered to be filed on the date shown on the postmark stamped by the United States Postal Service. If an appeal submitted by United States mail is not postmarked or the postmark does not show the date of mailing, the appeal is considered to be filed on the date it is received in the office of the Commission. A property owner who files an appeal with the Commission has the burden of proving that the appeal is timely."

Sec. 3. G.S. 153A-149(c) reads as rewritten:

"(c) Each county may levy property taxes for one or more of the purposes listed in this subsection up to ~~an effective~~ a combined rate of one dollar and fifty cents ($1.50) on the one hundred dollars ($100.00) appraised value of property subject to ~~taxation before the application of any assessment ratio.~~ taxation. ~~To find the actual rate limit for a particular county, divide the effective rate limit of one dollar and fifty cents ($1.50) by the county assessment ratio.~~ Authorized purposes subject to the rate limitation are:

(1) To provide for the general administration of the county through the board of county commissioners, the office of the county manager, the office of the county budget officer, the office of the county finance officer, the office of the county assessor, the office of the county tax collector, the county purchasing agent, and the county attorney, and for all other general administrative costs not allocated to a particular board, commission, office, agency, or activity of the county.

(2) Agricultural Extension. -- To provide for the county's share of the cost of maintaining and administering programs and services offered to agriculture by or through the Agricultural Extension Service or other agencies.

(3) Air Pollution. -- To maintain and administer air pollution control programs.

(4) Airports. -- To establish and maintain airports and related aeronautical facilities.

(5) Ambulance Service. -- To provide ambulance services, rescue squads, and other emergency medical services.

(6) Animal Protection and Control. -- To provide animal protection and control programs.

(6a) Arts Programs and Museums. -- To provide for arts programs and museums as authorized in G.S. 160A-488.

(6b) Auditoriums, coliseums, and convention and civic centers. -- To provide public auditoriums, coliseums, and convention and civic centers.

(7) Beach Erosion and Natural Disasters. -- To provide for shoreline protection, beach erosion control, and flood and hurricane protection.

(8) Cemeteries. -- To provide for cemeteries.

(9) Civil Preparedness. -- To provide for civil preparedness programs.

(10) Debts and Judgments. -- To pay and discharge any valid debt of the county or any judgment lodged against it, other than debts and judgments evidenced by or based on bonds and notes.

(10a) Defense of Employees and Officers. -- To provide for the defense of, and payment of civil judgments against, employees and officers or former employees and officers, as authorized by this Chapter.

(10b) Economic Development. -- To provide for economic development as authorized by G.S. 158-12.

(11) Fire Protection. -- To provide fire protection services and fire prevention programs.

(12) Forest Protection. -- To provide forest management and protection programs.

(13) Health. -- To provide for the county's share of maintaining and administering services offered by or through the county or district health department.

(14) Historic Preservation. -- To undertake historic preservation programs and projects.

(15) Hospitals. -- To establish, support and maintain public hospitals and clinics, and other related health programs and ~~facility,~~ facilities, or to aid any private, nonprofit hospital, clinic, related ~~facilities,~~ facility, or other health program or facility.

(15a) Housing Rehabilitation. -- To provide for personnel costs related to planning and administration of housing rehabilitation programs authorized by G.S. 153A-376. This subdivision only applies to counties with a population of 400,000 or more, according to the most recent decennial federal census.

(16) Human Relations. -- To undertake human relations programs.

(16a) Industrial Development. -- To provide for industrial development as authorized by G.S. 158-7.1.

(17) Joint Undertakings. -- To cooperate with any other county, city, or political subdivision in providing any of the functions, services, or activities listed in this subsection.

(18) Law Enforcement. -- To provide for the operation of the office of the sheriff of the county and for any other county law-enforcement agency not under the sheriff's jurisdiction.

(19) Libraries. -- To establish and maintain public libraries.

(20) Mapping. -- To provide for mapping the lands of the county.

(21) Medical Examiner. -- To provide for the county medical examiner or coroner.

(22) Mental Health. -- To provide for the county's share of the cost of maintaining and administering services offered by or through the area mental health, developmental disabilities, and substance abuse authority.

(23) Open Space. -- To acquire open space land and easements in accordance with Article 19, Part 4, Chapter 160A of the General Statutes.

(24) Parking. -- To provide off-street lots and garages for the parking and storage of motor vehicles.

(25) Parks and Recreation. -- To establish, support and maintain public parks and programs of supervised recreation.

(26) Planning. -- To provide for a program of planning and regulation of development in accordance with Article 18 of this Chapter and Article 19, Parts 3A and 6, of Chapter 160A of the General Statutes.

(27) Ports and Harbors. -- To participate in programs with the North Carolina Ports Authority and provide for harbor masters.

(27a) Railway Corridor Preservation. -- To acquire property for railroad corridor preservation as authorized by G.S. 160A-498.

(28) Register of Deeds. -- To provide for the operation of the office of the register of deeds of the county.

(29) Sewage. -- To provide sewage collection and treatment services as defined in G.S. 153A-274(2).

(30) Social Services. -- To provide for the public welfare through the maintenance and administration of public assistance programs not required by Chapters 108A and 111 of the General Statutes, and by establishing and maintaining a county home.

(31) Solid Waste. -- To provide solid waste collection and disposal services, and to acquire and operate landfills.

(31a) Stormwater. -- To provide structural and natural stormwater and drainage systems of all types.

(32) Surveyor. -- To provide for a county surveyor.

(33) Veterans' Service Officer. -- To provide for the county's share of the cost of services offered by or through the county veterans' service officer.

(34) Water. -- To provide water supply and distribution systems.

(35) Watershed Improvement. -- To undertake watershed improvement projects.

(36) Water Resources. -- To participate in federal water resources development projects.

(37) Armories. -- To supplement available State or federal funds to be used for the construction (including the acquisition of land), enlargement or repair of armory facilities for the North Carolina national guard.

(38) Railway Corridor Preservation. -- To acquire property for railroad corridor preservation as authorized by G.S. 160A-498."

Sec. 4. G.S. 153A-149(d) reads as rewritten:

"(d) With an approving vote of the people, any county may levy property taxes for any purpose for which the county is authorized by law to appropriate money. Any property tax levy approved by a

vote of the people shall not be counted for purposes of the rate limitation imposed in subsection (c).

The county commissioners may call a referendum on approval of a property tax levy. The referendum may be held at the same time as any other referendum or election, but may not be otherwise held within the period of time beginning 30 days before and ending 10 days after any other referendum or election to be held in the county and already validly called or scheduled by law at the time the tax referendum is called. The referendum shall be conducted by the county board of elections. The clerk to the board of commissioners shall publish a notice of the referendum at least twice. The first publication shall be not less than 14 days and the second publication not less than seven days before the last day on which voters may register for the referendum. The notice shall state the date of the referendum, the purpose for which it is being held, and a statement as to the last day for registration for the referendum under the election laws then in effect.

The proposition submitted to the voters shall be substantially in one of the following forms:

(1) Shall .... County be authorized to levy annually a property tax at ~~an effective~~ a rate not in excess of .... cents on the one hundred dollars ($100.00) value of property subject to taxation for the purpose of ....?

(2) Shall .... County be authorized to levy annually a property tax at a rate not in excess of that which will produce $........... for the purpose of ....?

(3) Shall .... County be authorized to levy annually a property tax without restriction as to rate or amount for the purpose of ....?

If a majority of those participating in the referendum approve the proposition, the board of commissioners may proceed to levy annually a property tax within the limitations (if any) described in the proposition.

The board of elections shall canvass the referendum and certify the results to the board of commissioners. The board of commissioners shall then certify and declare the result of the referendum and shall publish a statement of the result once, with the following statement appended: "Any action or proceeding challenging the regularity or validity of this tax referendum must be begun within 30 days after (date of publication)." The statement of results shall be filed in the clerk's office and inserted in the minutes of the board.

Any action or proceeding in any court challenging the regularity or validity of a tax referendum must be begun within 30 days after the publication of the results of the referendum. After the expiration of this period of limitation, no right of action or defense based upon the invalidity of or any irregularity in the referendum shall be asserted, nor shall the validity of the referendum be open to question in any court upon any ground whatever, except in an action or proceeding begun within the period of limitation prescribed herein.

Except for supplemental school taxes and except for tax referendums on functions not included in subsection (c) of this section, any referendum held before July 1, 1973, on the levy of property taxes is not valid for the purposes of this subsection. Counties in which such referendums have been held may support programs formerly supported by voted property taxes within the general rate limitation set out in subsection (c) at any appropriate level and are not subject to the former voted rate limitation."

Sec. 5. G.S. 153A-149(e) reads as rewritten:

"(e) With an approving vote of the people, any county may increase the property tax rate limitation imposed in subsection (c) and may call a referendum for that purpose. The referendum may be held at the same time as any other referendum or election, but may not be otherwise held within the period of time beginning 30 days before and ending 30 days after any other referendum or election. The referendum shall be conducted by the county board of elections.

The proposition submitted to the voters shall be substantially in the following form: "Shall the ~~effective~~ property tax rate limitation applicable to .... County be increased from ...... on the one hundred dollars ($100.00) value of property subject to taxation to .... on the one hundred dollars ($100.00) value of property subject to taxation?"

If a majority of those participating in the referendum approve the proposition, the rate limitation imposed in subsection (c) shall be increased for the county."

Sec. 6. G.S. 160A-209(e) reads as rewritten:

"(e) With an approving vote of the people, any city may levy property taxes for any purpose for which the city is authorized by its charter or general law to appropriate money. Any property tax levy approved by a vote of the people shall not be counted for purposes of the rate limitation imposed in subsection (d).

The city council may call a referendum on approval of a property tax levy. The referendum may be held at the same time as

any other city referendum or city election, but may not be otherwise held (i) on the day of any federal, State, district, or county election already validly called or scheduled by law at the time the tax referendum is called, or (ii) within the period of time beginning 30 days before and ending 10 days after the day of any other city referendum or city election already validly called or scheduled by law at the time the tax referendum is called. The referendum shall be conducted by the same board of elections that conducts regular city elections. A notice of referendum shall be published in accordance with G.S. 163-287. The notice shall state the date of the referendum, the purpose for which it is being held, and a statement as to the last day for registration for the referendum under the election laws then in effect.

The proposition submitted to the voters shall be substantially in one of the following forms:

(1) Shall the City/Town of .... be authorized to levy annually a property tax at ~~an effective~~ <u>a</u> rate not in excess of .... cents on the one hundred dollars ($100.00) value of property subject to taxation for the purpose of ....?

(2) Shall the City/Town of .... be authorized to levy annually a property tax at a rate not in excess of that which will produce $ .... for the purpose of ....?

(3) Shall the City/Town of .... be authorized to levy annually a property tax without restriction as to rate or amount for the purpose of ....?

If a majority of those participating in the referendum approve the proposition, the city council may proceed to levy annually a property tax within the limitations (if any) described in the proposition. ~~Unless otherwise provided in the proposition submitted to the voters, a vote on a property tax levy not to exceed a specified rate per one hundred dollars ($100.00) value of property subject to taxation is a vote on an effective rate per one hundred dollars ($100.00) of appraised value of property before the application of any assessment ratio.~~

The board of elections shall canvass the referendum and certify the results to the city council. The council shall then certify and declare the result of the referendum and shall publish a statement of the result once, with the following statement appended: 'Any action or proceeding challenging the regularity or validity of this tax referendum must be begun within 30 days after (date of publication).' The statement of results shall be

filed in the clerk's office and inserted in the minutes of the council.

Any action or proceeding in any court challenging the regularity or validity of a tax referendum must be begun within 30 days after the publication of the results of the referendum. After the expiration of this period of limitation, no right of action or defense based upon the invalidity of or any irregularity in the referendum shall be asserted, nor shall the validity of the referendum be open to question in any court upon any ground whatever, except in an action or proceeding begun within the period of limitation prescribed herein.

Except for tax referendums on functions not included in subsection (c) of this section, any referendum held before July 1, 1973, on the levy of property taxes is not valid for the purposes of this subsection. Cities in which such referendums have been held may support programs formerly supported by voted property taxes within the general rate limitations set out in subsection (d) at any appropriate level and are not subject to the former voted rate limitation."

Sec. 7. G.S. 160-209(f) reads as rewritten:

"(f) With an approving vote of the people, any city may increase the property tax rate limitation imposed in subsection (c) and may call a referendum for that purpose. The referendum may be held at the same time as any other city referendum or election, but may not be otherwise held (i) on the day of any federal, State, district, or county election, or (ii) within the period of time beginning 30 days before and ending 30 days after the day of any other city referendum or city election. The election shall be conducted by the same board of elections that conducts regular city elections.

The proposition submitted to the voters shall be substantially in the following form: 'Shall the ~~effective~~ property tax rate limitation applicable to the City/Town of .... be increased from .... on the one hundred dollars ($100.00) value of property subject to taxation to ...... on the one hundred dollars ($100.00) value of property subject to taxation?'

If a majority of those participating in the referendum approve the proposition, the rate limitation imposed in subsection (c) shall be increased for the city."

Sec. 8. This act is effective upon ratification.

Explanation of Proposal 4

Legislative Proposal 4 changes the date that starts the 30-day period in which a property owner has to appeal certain property tax decisions of the board of county commissioners. It also clarifies when a notice of appeal submitted by mail is considered received by the Property Tax Commission and deletes obsolete references in the local government statutes to assessment ratios.

A property owner has 30 days from the date of entry to file a notice of appeal with the Property Tax Commission from a decision of the board of county commissioners. The 30-day period begins on the date the decision is mailed to the property owner for an order of the board of equalization and review. Section 1 amends G.S. 105-290(e) to provide that the date on which the local board's decision is mailed starts the clock for either board.

Section 2 amends G.S. 105-290(g) to provide that a notice of appeal submitted by mail shall be deemed to be filed as of the date shown on the postmark. The current law provides that a notice is considered filed when it is received in the office of the Property Tax Commission. The existing language does not address notices submitted by mail. The change suggested in this section would prevent a taxpayer's right of appeal from being affected by how quickly the mail travels.

Sections 3 through 7 remove obsolete language from the city and county statutes. Prior to 1974, North Carolina did not use 100% assessment for property tax purposes. The board of county commissioners adopted a uniform percentage of the amount at which property in the county had been appraised as the value to be used in taxing the property. This percentage was known as the "assessment ratio". The local government statutes, in defining the property tax rate a city or county can levy, refers to the assessment ratio. When the State decided to assess all property at its true value, the application of any assessment ratio, and the corresponding language in these statutes, became unnecessary.

Section 8 provides that this act is effective upon ratification.

Fiscal Estimate - Legislative Proposal 4

Legislative Proposal 4 has no fiscal impact.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S OR H D

PROPOSAL 5 (89-LCX-330B)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Inheritance Tax Adjustment. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO PROVIDE AN INHERITANCE TAX EXEMPTION FOR STATE AND LOCAL GOVERNMENT RETIREMENT BENEFITS PAID TO LINEAL DESCENDANTS AND ANCESTORS AND TO LIMIT THE CURRENT INHERITANCE TAX EXEMPTION FOR FEDERAL GOVERNMENT RETIREMENT BENEFITS TO ONLY THOSE BENEFITS PAID TO LINEAL DESCENDANTS AND ANCESTORS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-3 reads as rewritten:

"§ 105-3. Property exempt.

The following property shall be exempt from taxation under this Article:

(1) Property passing to or for the use of any one or more of the following: the United States, any state, territory or any political subdivision thereof, or the District of Columbia, for exclusively public purposes.

(2) Property passing to religious, charitable, or educational corporations, or to churches, hospitals, orphan asylums, public libraries, religious, or charitable organizations, or passing to any trustee or trustees for religious or charitable purposes, where such religious, charitable, or educational institutions,

corporations, churches, trusts, etc., are located within the State and not conducted for profit.

(3) Property passing to religious, educational, or charitable corporations, foundations or trusts, not conducted for profit, incorporated or created or administered under the laws of any other state: If such other state levies no inheritance or estate taxes on property similarly passing from residents of such state to religious, educational or charitable corporations, foundations or trusts incorporated or created or administered under the laws of this State; or if such corporation, foundation or trust is one receiving and disbursing funds donated in this State for religious, educational or charitable purposes.

(4) The proceeds of all life insurance policies payable to beneficiaries named in subdivisions (1), (2) and (3) of this section. And also proceeds of all policies of insurance and the proceeds of all adjusted service certificates that have been or may be paid by the United States government, or that have been or may be paid on account of policies required to be carried by the United States government or any agency thereof, to the estate, beneficiary, or beneficiaries of any person who has served in the armed forces of the United States or in the merchant marine during the first or second World War or any subsequent military engagement; and proceeds, not exceeding the sum of twenty thousand dollars ($20,000), of all policies of insurance paid to the estate, beneficiary or beneficiaries of any person whose death was caused by enemy action during the second World War or any subsequent military engagement involving the United States. This provision will be operative only when satisfactory proof that the death was caused by enemy action is filed by the executor, administrator, or beneficiary with the Secretary of Revenue.

(5) The value of an annuity or other payment receivable by any beneficiary (other than the executor) under (a) an employees' trust (or under a contract or insurance policy purchased by an employees' trust) forming part of a pension, stock bonus, or

profit-sharing plan, which at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of 26 U.S.C. § 401(a); or (b) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan, which at the time of decedent's separation from employment (by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of 26 U.S.C. § 403(a) or § 403(b). If such amounts payable after the death of the decedent under a plan described in clause (a) or (b) are attributable to any extent to payments or contributions made by the decedent, no exemption shall be allowed for that part of the value of such amounts in the proportion that the total payments or contributions made by the decedent bears to the total payments or contributions made. For purposes of the preceding sentence contributions or payments made by the decedent's employer or former employer under a trust or plan described in clause (a) or (b) shall not be considered to be contributed by the decedent nor shall any deductible employee contributions within the meaning of 26 U.S.C. § 72(o)(5) be considered to have been contributed by the decedent. For purposes of this subdivision, contributions or payments on behalf of the decedent while he was an employee within the meaning of 26 U.S.C. § 401(c)(1) made under a trust or plan described in clause (a) or (b) shall, to the extent allowable as a deduction under 26 U.S.C. § 404, be considered to be made by a person other than the decedent and, to the extent not so allowable, shall be considered to be made by the decedent. Provided, that the value of such annuities or other payments receivable described in this subdivision shall not be exempt unless the payments received therefrom are or will be subject to income taxation under Article 4 of this Subchapter, and if such payments are not or will not be subject to income taxation under Article 4 of this Subchapter the value of such annuities or other payments receivable shall be included in the gross value of the estate of the

decedent and taxable under the provisions of this Article.

(6) The value of an annuity receivable by any beneficiary (other than the executor) under:

a. An individual retirement account described in section 408(a) of the Code,

b. An individual retirement annuity described in section 408(b) of the Code, or

c. A retirement bond described in section 409(a) of the Code.

If any payment to an account described in paragraph a or for an annuity described in paragraph b or a bond described in paragraph c was not allowable as a deduction under 26 U.S.C. § 219 or § 220 and was not a rollover contribution described in 26 U.S.C. §§ 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C), the preceding sentence shall not apply to that portion of the value of the amount receivable under such account, annuity, or bond (as the case may be) which bears the same ratio to the total value of the amount so receivable as the total amount which was paid to or for such account, annuity, or bond and which was not allowable as a deduction under 26 U.S.C. § 219 or § 220 and was not such a rollover contribution bears to the total amount paid to or for such account, annuity, or bond. For purposes of this subdivision, the term 'annuity' means an annuity contract or other arrangement providing for a series of substantially equal periodic payments to be made to a beneficiary (other than the executor) for his life or over a period extending for at least 36 months after the date of the decedent's death.

(7) The total value of proceeds of an annuity or other payment receivable by any beneficiary (other than the executor) under a military family protection, or survivor benefit, plan, or other comparable plan, pursuant to Chapter 73 of Title 10 of the United States Code.

(8) The value of an annuity ~~receivable by any beneficiary,~~ <u>or</u> other ~~than the estate,~~ <u>payment</u>

receivable by a Class A beneficiary under a ~~federal~~ government employee retirement or deferred compensation program to which the employee made ~~contributions during his working years.~~ contributions before retiring. The term 'deferred compensation program' includes a plan under section 401(k) of the Code, a federal thrift savings plan, and other deferred compensation arrangements. The term 'government' means the United States, a state, or a local unit of government.

(9) The total value of death benefits paid to a decedent's estate or a named beneficiary from voluntary pledges made by the North Carolina Highway Patrol or other association of law-enforcement officers employed by the State or a county or municipality, if the benefits are paid from an assessment against the members of the association.

(10) Property passing to the surviving spouse of a decedent."

Sec. 2. This act shall become effective September 1, 1990, and shall apply to the estates of decedents dying on or after that date.

Explanation of Proposal 5

Legislative Proposal 5 makes changes in the inheritance tax law relating to taxation of certain retirement and deferred compensation benefits. North Carolina's inheritance tax is a tax on the value of property that is transferred as a result of the death of an individual. Where the property is transferred to a surviving spouse, it is exempt from tax. The inheritance tax statutes divide all other beneficiaries into three classes--A, B, and C. Class A beneficiaries, lineal ancestors and descendents of the decedent (including stepchildren and adopted descendents), are allowed a collective credit of $26,150 against the tax imposed on property transferred to them. This credit effectively exempts at least the first $500,000 in property transferred to Class A beneficiaries. Other relatives and unrelated beneficiaries are taxed on all property passing to them.

The inheritance tax law exempts the value of an annuity payable to a survivor under a federal employee retirement program. Until 1989, amounts received from State and local retirement programs and deferred compensation funds were also exempt from inheritance tax. These exemptions were repealed in 1989, however, after the United States Supreme Court held in Davis v. Michigan that a state cannot give its own former employees more favorable tax treatment than it gives former federal employees. The Revenue Laws Study Committee weighed three proposals to equalize the inheritance tax treatment of federal, state, and local government employees: (i) eliminate the federal exemption, (ii) restore a state and local exemption equal to the federal exemption, or (iii) restore a state and local exemption for both annuities and deferred compensation and add an exemption for federal deferred compensation payments. The Committee devised a compromise, Legislative Proposal 5, which would restore the inheritance tax exemption for state and local government retirement and deferred compensation payments upon death, extend the existing exemption to include federal government deferred compensation payments upon death, and limit both exemptions to amounts receivable by Class A beneficiaries only. Amounts receivable by other beneficiaries would not be exempt from inheritance tax. The bill would become effective September 1, 1990, and would apply to the estates of decedents dying on or after that date.

PROPOSAL 5

FISCAL REPORT
FISCAL RESEARCH DIVISION
APRIL 16, 1990

Explanation of Proposal:
For years there has been a State inheritance tax exemption for the value of an annuity paid to a survivor under a federal employee retirement program, but not for a deferred compensation plan. Prior to 1989, the state and local retirement system law provided a blanket exemption from all state taxes for retirement benefits (including deferred compensation) for state and local retirees.

The *Davis* v. *Michigan* decision provided that a state could provide no greater tax relief to the retirement pay of its own employees (including local government) than that granted to federal retirees. The effect of this decision was to force a decision on whether to allow a full exclusion to federal deferred compensation benefits for survivors or to eliminate the exclusion for state and local retirees. As part of the pension tax re-write in response to *Davis*, the state and local exclusion was eliminated.

Transfers to spouses are totally exempt from the inheritance tax. In general, the first $500,000 of property (including the present value of an annuity) transferred to Class A beneficiaries (lineal ancestors, lineal descendants) is exempt. Class B beneficiaries (other relatives) and Class C beneficiaries (non-relatives) receive no exemption.

Explanation of Proposal:

(1) Extends the existing inheritance tax exemption for survivors of federal retirees to include the present value of deferred compensation benefits.
(2) Limits the inheritance tax exemption for the value of federal, state, and local survivor annuities and deferred compensation plans to Class A beneficiaries.

Effective Date:
Deaths occurring on or after September 1, 1990.

Fiscal Effect:
Because estates are allowed nine months to file an inheritance tax return after a death, the enactment of the proposal would have no impact on General Fund tax revenue for the current 1989-91 biennium.

The impact on future years will be insignificant because:

(1) Most survivor annuity and deferred comp beneficiaries go to the spouse (fully exempt from tax)
(2) There is a $500,000 exemption for transfers to other Class A beneficiaries
(3) Eliminating Class B beneficiaries from the exclusion will help offset any revenue loss from extending the federal exclusion to deferred compensation benefits.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S/H D

PROPOSAL 6 (89-LC-341)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Fuel Tax Bond Increase. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO INCREASE THE MAXIMUM BOND THAT MAY BE REQUIRED OF FUEL DISTRIBUTORS AND SUPPLIERS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-433 reads as rewritten:

"**§ 105-433. Application for license as distributor.**

Any distributor engaged in business on April 1, 1931, shall, within 30 days thereafter, and any other distributor shall, prior to the commencement of doing business, file a duly acknowledged application for a license with the Secretary of Revenue on a form prescribed and furnished by him setting forth the name under which such distributor transacts or intends to transact business within this State, the address of each place of business and a designation of the principal place of business. If such distributor is a firm or association, the application shall set forth the name and address of each person constituting the firm or association, and if a corporation, the names and addresses of the principal officers and such other information as the Secretary of Revenue may require. Each distributor shall at the same time file a bond in such amount, ~~not exceeding forty thousand dollars ($40,000)~~ in such ~~form~~ form, and with such surety or sureties as may be required by the Secretary of Revenue, conditioned upon the rendition of the reports and the payment of the tax hereinafter provided for. The amount of the

bond required by the Secretary may not exceed two times the distributor's average monthly tax liability under this Article or, in the case of an initial bond, two times the distributor's estimated average monthly tax liability under this Article, as determined by the Secretary. A distributor who is also required to be bonded under G.S. 105-449.5 as a supplier of special fuels may file a single bond, under either this section or under G.S. 105-449.5, for the combined amount required under these sections ~~but not exceeding eighty thousand dollars ($80,000)~~ and conditioned upon compliance with the requirements of Article 36 and Article 36A of this Subchapter. A distributor required to file a bond under this section shall, within 30 days after receiving a notice from the Secretary of Revenue, file an additional bond in the amount requested by the Secretary. The amount of the initial bond and any additional bonds filed by the distributor, however, may not exceed the limits set in this section. Upon approval of the application and bond, the Secretary of Revenue shall issue to the distributor a nonassignable license with a duplicate copy for each place of business of said distributor in this State, which shall be displayed in a conspicuous place at each such place of business and shall continue in force until surrendered or canceled. No distributor shall sell, offer for sale, or use any motor fuels within this State until such license has been issued. Any distributor failing to comply with or violating any of the provisions of this section shall be guilty of a misdemeanor and upon conviction thereof shall be fined not less than one hundred dollars ($100.00), nor more than five thousand dollars ($5,000), or imprisonment for not more than 24 months, or both."

Sec. 2. G.S. 105-449.5 reads as rewritten:

"**§ 105-449.5. Supplier to file bond.**

A supplier's license shall not be issued until the applicant has filed with the Secretary a bond in the approximate sum of ~~three~~ two times the average monthly tax due to be paid by ~~such supplier,~~ the supplier, as determined by the Secretary, but the amount of the bond shall in no case be less than five hundred dollars ($500.00). ~~($500.00) nor more than forty thousand dollars ($40,000).~~ Such bond shall be in such form and with such surety or sureties as may be required by the Secretary, conditioned upon making proper reports and paying the tax provided for in this Article, and otherwise complying with the provisions of this Article. A supplier who is also required to be bonded under G.S. 105-433 as a distributor of motor fuels may file a single bond, under either this section or under G.S. 105-433 for the combined

amount required under these sections, ~~sections but not exceeding eighty thousand dollars ($80,000),~~ and conditioned upon compliance with the requirements of Article 36 and Article 36A of this Subchapter. A supplier required to file a bond under this section shall, within 30 days after receiving a notice from the Secretary, file an additional bond in the amount requested by the Secretary. The amount of the initial bond and any additional bonds filed by the supplier, however, may not exceed the limits set in this section."

Sec. 3. This act shall become effective January 1, 1991.

Explanation of Proposal 6

Legislative Proposal 6 increases the maximum bond that may be required of fuel distributors and suppliers. Distributors of motor fuel are subject to the Gasoline Tax under Article 36 of Chapter 105 of the General Statutes. Distributors must obtain a license from the Department of Revenue and post a bond in the amount required by the Secretary of Revenue, up to a maximum of $40,000. Suppliers of special fuels are subject to the Special Fuels Tax under Article 36A of Chapter 105 of the General Statutes. Suppliers must obtain a license from the Department of Revenue and post a bond in the approximate sum of three times the supplier's average monthly tax liability, up to a maximum of $40,000. Distributors who are also suppliers may obtain a single bond to cover both taxes, up to a maximum bond of $80,000.

The Department of Revenue notified the Revenue Laws Study Committee that one of its taxpayers recently defaulted on over $1,000,000 in gasoline tax liability and had filed for bankruptcy. The State will probably be unable to recover most of this liability beyond the $80,000 bond coverage. Many other taxpayers have monthly liabilities well in excess of the maximum bond amounts. The Department of Revenue stated that substantial amounts of State tax proceeds may be at risk due to the increasing number of delinquencies and bankruptcies of fuel distributors and suppliers. The Department suggested that a maximum bond requirement of three times the taxpayer's average monthly liability would be appropriate to protect the State's interests.

A representative of the Petroleum Marketers' Association, Donald M. Ward, informed the Committee that this increase in the maximum bond might harm small businesses. The Committee directed Mr. Ward to work with the Department of Revenue to craft a proposal that would protect the interests of the State without placing an undue burden on small businesses. The Committee adopted a compromise, Legislative Proposal 6, that would increase the maximum bond liability to two times the taxpayer's average monthly liability. The bill would become effective January 1, 1991. If the Department of Revenue and the Petroleum Marketers' Association develop another compromise that might better balance the needs of the State and the needs of small businesses, that compromise could be submitted as a committee substitute for Legislative Proposal 6 during the 1990 Session.

[illegible] of Proposal

[illegible] a [illegible] the [illegible] bond that must be [illegible] of fuel [illegible] and [illegible]. [illegible] of [illegible] fuel [illegible] to the [illegible] Tax [illegible] 39 of Chapter [illegible] of the General Statutes. [illegible] must obtain a [illegible] from the Department of Revenue and post a bond in the amount required by the [illegible] of Revenue, up to a maximum of $[illegible]. [illegible] of [illegible] fuels are [illegible] to the [illegible] [illegible]. The [illegible] [illegible] tax of Chapter [illegible] of the General Statutes. [illegible] must obtain a license from the Department of Revenue and post a [illegible] the [illegible] of [illegible] the [illegible] [illegible] [illegible] tax liability, up to a maximum of $[illegible]. [illegible] who are also [illegible] may obtain a single [illegible] [illegible], up to a maximum bond of $[illegible].

The Department of Revenue [illegible] the [illegible] [illegible] Study Commission that [illegible] [illegible] [illegible] [illegible] [illegible] $[illegible] in [illegible] for [illegible] and [illegible] [illegible]. The State will probably be unable to recover some of that [illegible] [illegible] the [illegible] [illegible]. [illegible] other [illegible] have [illegible] [illegible] [illegible] of the maximum bond amount. The Department of Revenue stated that [illegible] [illegible] the [illegible] may be at risk due to the increasing number of [illegible] and [illegible] of fuel distributors and suppliers. The Department [illegible] that a maximum bond requirement of [illegible] [illegible] the [illegible] average [illegible] should be appropriate to protect the State's interests.

A representative of the [illegible] [illegible] Association, [illegible] M. [illegible], [illegible] the Commission that this increase in the maximum bond might have [illegible] [illegible]. The Commission directed Mr. [illegible] to work with the Department of [illegible] to draft a proposal that would protect the interests of the State without placing [illegible] burden on [illegible] businesses. The Commission adopted a compromise [illegible], that would increase the maximum bond [illegible] to [illegible] [illegible] the [illegible] [illegible] liability. The bill would become effective January 1, [illegible]. [illegible] Department of Revenue and the [illegible] [illegible] Association [illegible] [illegible] that [illegible] [illegible] between the [illegible] of the State and the [illegible] of [illegible], that [illegible] could be [illegible] at a [illegible] [illegible] [illegible] [illegible] during the [illegible] [illegible].

Fiscal Estimate - Legislative Proposal 6

Legislative Proposal 6 has no fiscal impact.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S OR H D

PROPOSAL 7 (90-LJ-R12)
THIS IS A DRAFT

Short Title: No Sales Tax on Small Power Producer (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ALLOW A SALES TAX EXEMPTION FOR FUEL USED BY A SMALL POWER PRODUCER TO GENERATE ELECTRICITY.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.13 is amended by adding a new subdivision to read:

"(8a) Sales to a small power production facility, as defined in 16 U.S.C. § 796(17)(A), of fuel used by the facility to generate electricity."

Sec. 2. This act shall become effective July 1, 1990.

Explanation of Proposal 7

Proposal 7 creates a sales tax exemption for fuel used by a small power producer to generate electricity. Without the exemption, the fuel would be subject to sales tax at the rate of 1% under G.S. 105-164.4(a)(1c)d.

The United States Code, in 16 U.S.C. § 796(17)(A), defines a "small power production facility" as a facility that produces energy by using primarily biomass waste, renewable resources, geothermal resources, or any combination of these and has a power production capacity of not more than 80 megawatts. The purpose of the federal law is to encourage the production of energy from alternative energy sources.

A small power production facility is under construction in Craven County that will use wood chips as its source of fuel. Representatives of the facility addressed the Revenue Laws Study Committee and requested that the wood chips that will be used by the facility be exempted from sales tax. The spokesperson stressed that the wood chips should be treated the same as coal, which is exempt from sales tax under an exemption for products of the mine or the forest in their original state.

The Committee considered the current sales tax law on fuel. As noted, coal used to generate electricity is exempt from sales tax under G.S. 105-164.13(3). Piped natural gas used to generate electricity is subject to State sales tax at the rate of 3% and is not subject to local sales tax. Other fuel used to generate electricity is subject to State sales tax under G.S. 105-164.4(a)(1c)d. at the rate of 1% and is not subject to local sales tax.

The Committee decided to recommend the exemption as part of a policy of encouraging the use of alternative fuels. Also, the Committee found little difference between the wood chips intended for use by the Craven facility and coal. The exemption, however, applies to any fuel used by a small power production facility and could include solid waste in the event a facility pays for solid waste used to convert to electricity. The proposal becomes effective July 1, 1990.

PROPOSAL 7

FISCAL REPORT
FISCAL RESEARCH DIVISION
APRIL 17, 1990

Explanation of Proposal:

Proposal 7 exempts from sales tax fuel used by a small power producer to generate electricity.

Effective Date:

July 1, 1990.

Fiscal Effect:

This proposal has no immediate fiscal effect because there are no operating small power producers that purchase fuel. The few small power producers currently in operation use solid waste or methane gas produced from solid waste and do pay for the waste or the gas.

When the Craven County project becomes operational, there will be an annual loss of State sales tax revenue of $60,950 and no loss of local sales tax revenue because the exempt fuel would have been subject to State sales tax only. If all the other five small power producer projects with plans to use fuel that is potentially subject to sales tax become operational, the annual loss in State sales tax revenue could be an additional $30,000, for a total of $90,950.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S OR H D

PROPOSAL 8 (90-LJ-R13)
THIS IS A DRAFT

Short Title: Modify Taxation of N.C. Enterprise Corp. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REVISE THE TAXATION OF A NORTH CAROLINA ENTERPRISE CORPORATION AND TO EXTEND THE TAX CREDIT FOR INVESTMENTS IN AN ENTERPRISE CORPORATION.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-125 reads as rewritten:

"§ 105-125. Corporations not mentioned.

None of the taxes levied in this Article shall apply to charitable, religious, fraternal, benevolent, scientific or educational corporations, not operating for a profit; nor to insurance companies; nor to mutual ditch or irrigation associations, mutual or cooperative telephone associations or companies, mutual canning associations, cooperative breeding associations, or like organizations or associations of a purely local character deriving receipts solely from assessments, dues, or fees collected from members for the sole purpose of meeting expenses; nor to cooperative marketing associations operating solely for the purpose of marketing the products of members or other farmers, which operations may include activities which are directly related to such marketing activities, and turning back to them the proceeds of sales, less the necessary operating expenses of the association, including interest and dividends on capital stock on the basis of the quantity of product furnished by them; nor to production credit associations organized under

the act of Congress known as the Farm Credit Act of 1933; nor to business leagues, boards of trade, clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, civic leagues operated exclusively for the promotion of social welfare, or chambers of commerce and merchants' associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder, individual or other corporations; nor to corporations or organizations, such as condominium associations, homeowner associations or cooperative housing corporations not organized for profit, the membership of which is limited to the owners or occupants of residential units in the condominium, housing development, or cooperative housing corporation, and operated exclusively for the management, operation, preservation, maintenance or landscaping of the common areas and facilities owned by such corporation or organization or its members situated contiguous to such houses, apartments or other dwellings or for the management, operation, preservation, maintenance and repair of such houses, apartments or other dwellings owned by the corporation or organization or its members, but only if no part of the net earnings of such corporation or organization inures (other than through the performance of related services for the members of such corporation or organization) to the benefit of any member of such corporation or organization or other person. In addition, absent a specific provision to the contrary, the taxes levied in this Article do not apply to any organization that is exempt from federal income tax under the Code.

Provided, that each such corporation must, upon request by the Secretary of Revenue, establish in writing its claim for exemption from said provisions. The provisions of G.S. 105-122 and 105-123 shall apply to electric light, power, gas, water, Pullman, sleeping and dining car, express, telegraph, telephone, motor bus, and truck corporations to the extent and only to the extent that the franchise taxes levied in G.S. 105-122 and 105-123 exceed the franchise taxes levied in other sections of this Article or schedule; except that the provisions of G.S. 105-122 and 105-123 shall not apply to businesses taxed under G.S. 105-120.1. The exemptions in this section shall apply only to those corporations specially mentioned, and no other.

~~Provided, that any corporation doing business in North Carolina which in the opinion of the Secretary of Revenue of North Carolina, qualifies as a "regulated investment company" under section 851 of the Code or as a "real estate investment trust" under the provisions of section 856 of the Code and which~~

~~files with the North Carolina Department of Revenue its election to be treated as a "regulated investment company" or as a "real estate investment trust," shall in determining its basis for franchise tax be allowed to~~ The following corporations may deduct the aggregate market value of ~~its~~ their investments in the stocks, bonds, debentures, or other securities or evidences of debt of other ~~corporations, partnerships, individuals, municipalities, governmental agencies or governments.~~ entities in determining their basis for franchise tax:

(1) A regulated investment company under section 851 of the Code that files an election with the Department to be treated as a regulated investment company.

(2) A real estate investment trust under section 856 of the Code that files an election with the Department to be treated as a real estate investment trust.

(3) A North Carolina Enterprise Corporation established under Article 3 of G.S. Chapter 53A."

Sec. 2. G.S. 105-130.7(3) reads as rewritten:

"(3) A corporation ~~shall be allowed to deduct such proportionate part of dividends received by it from a regulated investment company or a real estate investment trust, as defined in G.S. 105-130.12, as represents and corresponds to income received by such regulated investment company or real estate investment trust which would not be taxed by this State if received directly by the corporation.~~ may deduct dividends received from a corporation listed in this subdivision to the extent the dividends are attributable to income that would be exempt from tax under this Division if received by the corporation claiming the deduction:

a. A regulated investment company under section 851 of the Code that files an election with the Department to be treated as a regulated investment company.

b. A real estate investment trust under section 856 of the Code that files an election with the Department to be treated as a real estate investment trust.

c. A North Carolina Enterprise Corporation established under Article 3 of G.S. Chapter 53A."

Sec. 3. G.S. 105-130.12 reads as rewritten:

"§ 105-130.12. ~~Regulated investment companies and real estate investment trusts.~~ Corporations taxed on undistributed income.

~~Any organization or trust which, in the opinion of the Secretary of Revenue of North Carolina, qualifies as either a "regulated investment company" under section 851 of the Code or as a "real estate investment trust" under section 856 of the Code and which files with the North Carolina Department of Revenue its election to be treated as a "regulated investment company," or as a "real estate investment trust"~~ The following corporations shall be taxed under this Division upon only that part of ~~its~~ their net income ~~which~~ that is not distributed or declared for distribution to shareholders during the income year or by the time required by law for the filing of the return for the income year including the period of any extension of time granted for filing ~~such~~ the ~~return.~~ return:

(1) A regulated investment company under section 851 of the Code that files an election with the Department to be treated as a regulated investment company.

(2) A real estate investment trust under section 856 of the Code that files an election with the Department to be treated as a real estate investment trust.

(3) A North Carolina Enterprise Corporation established under Article 3 of G.S. Chapter 53A."

Sec. 4. G.S. 105-212(c) reads as rewritten:

"(c) ~~Any corporation or trust doing business in North Carolina which in the opinion of the Secretary of Revenue of North Carolina qualifies as a "regulated investment company" under section 851 of the Code or as a "real estate investment trust" under the provisions of section 856 of the Code and which files with the North Carolina Department of Revenue its election to be treated as a "regulated investment company" or "real estate investment trust," shall not be subject to any of the taxes levied in this Article or schedule.~~ The following entities are exempt from the taxes levied in this Article:

(1) A regulated investment company under section 851 of the Code that files an election with the Department to be treated as a regulated investment company.

(2) A real estate investment trust under section 856 of the Code that files an election with the Department to be treated as a real estate investment trust.

(3) A North Carolina Enterprise Corporation established under Article 3 of G.S. Chapter 53A."

Sec. 5. G.S. 105-163.011(a) reads as rewritten:

"(a) Corporations. -- Subject to the limitations contained in G.S. 105-163.012, a corporation that invests in the equity securities of a North Carolina Capital Resource Corporation, a North Carolina Enterprise Corporation, or a qualified investment organization is allowed as a credit against the income tax imposed by Division I of this ~~Article or the~~ Article, the franchise tax imposed by G.S. 105-116, 105-120.2, and ~~105-122~~ 105-122, or the gross premiums tax imposed by G.S. 105-228.5 and 105-228.8 for the taxable year an amount equal to twenty-five percent (25%) of the amount invested or seven hundred fifty thousand dollars ($750,000), whichever is less. The credit may not be taken for the year in which the investment is made but shall be taken for the taxable year beginning during the calendar year following the calendar year in which the investment was made."

Sec. 6. G.S. 105-163.012(a) reads as rewritten:

"(a) The credit allowed a taxpayer under G.S. 105-163.011 may not exceed the amount of income tax imposed by Division I or II of this ~~Article or by~~ Article, the amount of franchise tax imposed by Article 3 of this Chapter, or the amount of gross premiums tax imposed by Article 8B of this Chapter, as appropriate, for the taxable year reduced by the sum of all other credits allowable except tax payments made by or on behalf of the taxpayer. The amount of unused credit allowed under G.S. 105-163.011 may be carried forward for the next five succeeding years."

Sec. 7. This act is effective for taxable years beginning on or after January 1, 1990.

Explanation of Proposal 8

Legislative Proposal 8 makes two changes in the laws enacted in 1988 concerning North Carolina Enterprise Corporations. First, it changes the way a North Carolina Enterprise Corporation is taxed under the corporate income tax, the franchise tax, and the intangibles tax to treat an Enterprise Corporation like a regulated investment company or a real estate investment trust rather than like a typical corporation. Second, it extends the tax credit allowed for those who invest in a North Carolina Enterprise Corporation to include the gross premiums tax payable by insurance companies.

A North Carolina Enterprise Corporation is a corporation organized under Chapter 53A of the General Statutes to, in effect, provide venture capital for economic development in rural North Carolina. Since the enactment of the authorizing legislation in 1988, one Enterprise Corporation has been established. The Corporation has received subscriptions for a total of $20 million in capital stock, $10 million of which is from the State. The State encourages investment in the Corporation by others by allowing a tax credit against income tax and franchise tax of 25% of the amount invested or $750,000, whichever is less.

Changing the laws to treat the Enterprise Corporation as a regulated investment company or a real estate investment trust will have the following effects:

(1) For franchise tax, the change will reduce the tax base of the Corporation by the market value of its investments in stocks, bonds, and debentures.

(2) For corporate income taxes, the change will exempt from tax the income of the Corporation that is distributed or set aside for distribution to investors in the Corporation.

(3) For intangible personal property taxes, the change will exempt stocks, bonds, and evidences of debt owned by the Corporation from tax.

Extending the tax credit to include the gross premiums tax will allow insurance companies that invest in the Enterprise Corporation to reduce the gross premiums taxes payable by them by 25% of the amount invested or $750,000, whichever is less. Insurance companies do not pay corporate income tax or franchise tax and therefore do not have the same incentive under current law as other corporations and financial institutions to invest in the Enterprise Corporation. Extension of the credit to insurance

companies does not affect the annual $12 million ceiling on the total credits for investments in the Enterprise Corporation.

The Revenue Laws Study Committee considered this proposal at the request of the North Carolina Enterprise Corporation. The Committee endorses the Corporation and its purpose but was somewhat hesitant to recommend what appears to be tax exemptions for fear of encouraging other entities to request similar treatment. The Committee nevertheless decided to recommend this proposal and to present the issue to the 1990 Session.

In adopting the recommendation, the Committee urged the Corporation to consider amending its authorizing legislation so that the Corporation can be organized as a limited partnership rather than as a corporation. Organization as a partnership would benefit the Corporation by eliminating the issue of federal or State corporate income tax and state franchise tax and would not create the appearance of granting exemptions from tax.

PROPOSAL 8

FISCAL REPORT
FISCAL RESEARCH DIVISION
APRIL 17, 1990

Explanation of Proposal:

Proposal 8 makes the following changes concerning a North Carolina Enterprise Corporation:

(1) Reduces the franchise tax base of the North Carolina Enterprise Corporation by the market value of its investments in stocks, bonds, and debentures.

(2) Exempts from income tax income of the North Carolina Enterprise Corporation that is either distributed to or set aside for distribution to shareholders of the Corporation.

(3) Makes clear that stocks, bonds, and evidences of debt owned by the North Carolina Enterprise Corporation are exempt from taxes on intangible personal property.

(4) Provides insurance companies with a credit against the gross premiums tax of 25% of the amount invested in the North Carolina Enterprise Corporation, not to exceed $750,000.

Effective Date:

Taxable years beginning on or after January 1, 1990.

Fiscal Effect:

For FY 1990-91, the maximum revenue loss would be less than $10,000.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S/H D

PROPOSAL 9 (89-LCX-325)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Revenue Laws Tech Changes. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL CHANGES TO THE REVENUE LAWS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-33(d) reads as rewritten:

"(d) The State license issued under G.S. 105-41, 105-42, 105-45, 105-53, 105-54, 105-55, ~~105-57,~~ 105-58, and 105-91 shall be and constitute a personal privilege to conduct the profession or business named in the State license, shall not be transferable to any other person, firm or corporation and shall be construed to limit the person, firm or corporation named in the license to conducting the profession or business and exercising the privilege named in the State license to the county and/or city and location specified in the State license, unless otherwise provided in this Article or schedule. Other license issued for a tax year for the conduct of a business at a specified location shall upon a sale or transfer of the business be deemed a sufficient license for the succeeding purchaser for the conduct of the business specified at such location for the balance of the tax year: Provided, that if the holder of a license under this schedule moves the business for which a license has been paid to another location, a new license may be issued to the licensee at a new location for the balance of the license year, upon surrender of the original license for cancellation and the

payment of a fee of five dollars ($5.00) for each license certificate reissued."

Sec. 2. G.S. 105-38(h) reads as rewritten:

"(h) Counties, cities, and towns may levy a license tax on the business taxed under this section not in excess of one half of the license tax levied by the State, but shall not levy a parade tax or a tax under ~~subsection (h) [subsection (g)]~~ subsection (g) of this section."

Sec. 3. G.S. 105-53(i) reads as rewritten:

"(i) Display and Possession of Licenses and Identification. -- An itinerant merchant shall keep both the license required by this section and the retail sales tax license conspicuously and prominently displayed, so as to be visible for inspection by patrons of the itinerant merchant at the places or locations at which the goods are to be sold or offered for sale. A peddler shall have the license required by this section and the retail sales tax license with him at all times he offers goods for sale and must produce them upon the request of any customer, State ~~and/or~~ or local revenue agent, or law enforcement agent. A specialty market vendor shall keep the retail sales tax license conspicuously and prominently displayed, so as to be visible for inspection by patrons of the specialty market vendor at the places or locations at which the goods are to be sold or offered for sale. A specialty market operator shall have the license required by this section available for inspection during all times that the specialty market is open and must produce it upon the request of any customer, State ~~and/or~~ or local revenue agent, or law enforcement agent.

Upon the request of any customer, State ~~and/or~~ or local revenue agent, or law enforcement agent, a peddler, itinerant merchant, specialty market operator, or specialty market vendor shall provide its name and permanent address. If the peddler, itinerant merchant, specialty market operator, or specialty market vendor is not a corporation, he shall, upon the request of any customer, State ~~and/or~~ or local revenue agent, or law enforcement agent, provide a valid driver's license, a special identification card issued under G.S. 20-37.7, military identification, or a passport bearing a physical description of the person named reasonably describing the peddler, itinerant merchant, specialty market operator, or specialty market vendor. If the peddler, itinerant merchant, specialty market operator, or specialty market vendor is a corporation, it shall, upon the request of any customer, State ~~and/or~~ or local revenue agent, or law enforcement agent, give the name and registered agent of the

corporation and the address of the registered office of the corporation, as filed with the North Carolina Secretary of State."

Sec. 4. G.S. 105-90.1 is repealed.

Sec. 5. G.S. 105-109.1 reads as rewritten:

"**§ 105-109.1. Interest.**

With respect to the taxes on gross receipts levied in G.S. 105-37.1(a), ~~105-38(7), 105-39(c)~~ 105-38(f), and 105-65.1(b)(2), and the tax on installment paper dealers levied in G.S. 105-83(b), all such taxes, including assessments of taxes or additional taxes, shall bear interest from the time such taxes were due to have been paid until paid, at rates established pursuant to G.S. 105-241.1(i)."

Sec. 6. G.S. 105-113.110 reads as rewritten:

"**§ 105-113.110. Violations of Article a felony.**

(a) A dealer who ~~violates this Article~~ possesses marijuana or any other controlled substance or counterfeit controlled substance upon which the tax due under this Article has not been paid, as evidenced by a stamp, is guilty of a Class I ~~felony, and is subject to an additional penalty of one hundred percent (100%) of any tax due from the dealer.~~ felony.

(b) Notwithstanding any other provision of law, no prosecution for a violation of this Article shall be barred before the expiration of six years after the date of the violation."

Sec. 7. Article 2D of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-113.110A. Interest and penalty.**

The tax due under this Article shall bear interest at the rate established pursuant to G.S. 105-241.1(i) from the date due until paid. In addition, a dealer who neglects, fails, or refuses to pay the tax due under this Article is liable for a penalty equal to one hundred percent (100%) of the tax."

Sec. 8. G.S. 114-18.1(a) reads as rewritten:

"(a) Every local law enforcement agency and every State law enforcement agency shall, within 48 hours after making an arrest of an individual in possession of ~~a controlled substance or a counterfeit controlled substance,~~ more than 42.5 grams of marijuana, seven or more grams of any other controlled substance or counterfeit controlled substance that is sold by weight, or 10 or more dosage units of any other controlled substance or counterfeit controlled substance that is not sold by weight, upon which a North Carolina controlled substance tax stamp is not affixed, report the arrest to the State Bureau of Investigation. Every local law enforcement agency and every State law

enforcement agency shall, within 48 hours after seizing any of the above specified quantities of a non-tax-paid controlled substance or a counterfeit controlled substance, report the seizure to the State Bureau of Investigation. The ~~report~~ report, to be in the form prescribed by the Secretary of Revenue, shall include the time and place of the arrest or seizure, the ~~amount and location~~ amount, location, and kind of the substance, ~~and the identification~~ identification, including the social security number, of any individual in possession of the ~~substance.~~ substance, and any other information prescribed by the Secretary of Revenue."

Sec. 9. G.S. 114-19(b) reads as rewritten:

"(b) The State Bureau of Investigation shall, on a daily basis, notify the Department of Revenue of all reports it receives pursuant to G.S. 114-18.1 of arrests and seizures involving non-tax-paid controlled substances and counterfeit controlled substances. The Bureau shall also, as soon as practicable, provide the Department with any additional information it receives regarding such arrests and seizures."

Sec. 10. G.S. 105-116(g) reads as rewritten:

"(g) The Secretary of Revenue shall determine the total gross receipts derived from the sale within each municipality of the commodities or services described in this section, except water and sewerage services, and shall distribute to each municipality an amount equal to a tax of three and nine hundredths percent (3.09%) of the gross receipts from sales within the municipality. ~~In determining the amount to be distributed to a municipality pursuant to this subsection, gross receipts from sales within a municipality do not include receipts from sales of piped gas to a manufacturer for use as an ingredient or component part of a manufactured product.~~

As soon as practicable after the date on which each quarterly payment of taxes is due under this section, the Secretary of Revenue shall certify to the State Disbursing Officer and to the State Treasurer the amount distributable to each municipality under this section. The State Disbursing Officer shall thereupon issue a warrant on the State Treasurer to each municipality in the amount so certified.

So long as there is a distribution to municipalities of the amount herein provided from the tax imposed by this section, no municipality shall impose or collect any greater franchise, privilege or license taxes, in the aggregate, on the businesses taxed under this section, than was imposed and collected on or before January 1, 1947. If any municipality shall have collected

any privilege, license or franchise tax between January 1, 1947, and April 1, 1949, in excess of the tax collected by it prior to January 1, 1947, then upon distribution of the taxes imposed by this section to municipalities, the amount distributable to any municipality shall be credited with such excess payment."

Sec. 11. G.S. 105-120(d) reads as rewritten:

"(d) The Secretary of Revenue shall ascertain the total gross receipts derived from local business conducted within each municipality in this State by persons, firms or corporations taxed under this section, and out of the tax levied by this section, an amount equal to a tax of three and nine hundredths percent (3.09%) of the gross receipts from local business conducted within any municipality shall be distributed to such municipality. ~~When a person, firm or corporation taxed under this section properly receives a credit on said taxes under the proviso in subsection (b) because of payments made to a municipality, such municipality's distributive share of the taxes levied by this section shall be reduced by the amount of the credit properly received by said person, firm or corporation. If the credit received under the proviso is greater than the municipality's distributive share of the taxes levied under this section, no distribution to such municipality shall be made.~~

As soon as practicable after the date on which each quarterly payment of taxes is due under this section, the Secretary of Revenue shall certify to the State Disbursing Officer and to the State Treasurer the amount distributable to each municipality under this section. The State Disbursing Officer shall thereupon issue a warrant on the State Treasurer to each municipality in the amount so certified.

In determining what constitutes local business conducted within a municipality for the purposes of this subsection, all business originating within a municipality, except long-distance calls, shall be construed as local business.

The Department of Revenue is hereby authorized and empowered to require any and all persons, firms or corporations taxed under this section to file additional reports disclosing the gross receipts derived from local business as herein defined and the gross receipts from long-distance business.

If the records of the corporation taxed under this section do not readily disclose allocation to municipalities of revenues from local business as above defined, the Secretary of Revenue shall prescribe some practicable method of allocating such local revenues."

Sec. 12. G.S. 105-130.7(1) reads as rewritten:

"(1) As soon as may be practicable after ~~the close~~ September 30 of each ~~calendar~~ year, the Secretary of Revenue shall determine from ~~each~~ the corporate income tax return filed ~~with him~~ during ~~such year, and due from the filing corporation~~ the year ending September 30 by each corporation required to file a return during ~~such year,~~ that period the proportion of the entire net income or loss of the corporation allocable to this State under the provisions of G.S. 105-130.4, except as provided ~~herein; if~~ herein. If a corporation has a net income in North Carolina and a net loss from all sources wherever located, or if a corporation has a net loss in North Carolina and a net income from all sources wherever located, the Secretary shall require the use of the allocation fraction determined under the provisions of G.S. 105-130.4. A corporation which is a stockholder in any such corporation shall be allowed to deduct the same proportion of the dividends received by it from such corporation during its income year ending ~~at~~ on or after ~~the end of such calendar year.~~ September 30. No deduction shall be allowed for any part of any dividend received ~~by such corporation~~ from any corporation ~~which filed no~~ that was required to file an income tax return ~~with the Secretary of Revenue~~ during ~~such calendar year.~~ the year ending September 30 but failed to file the return. In the case of dividends received from a corporation that was not required to file a return during the year ending September 30, the proportion of dividends deductible by the stockholder shall be determined by the Secretary from the best information available."

Sec. 13. G.S. 105-130.27(g) reads as rewritten:

"(g) Expiration. This section applies only to costs incurred during taxable years beginning prior to January 1, ~~1993.~~ 1994."

Sec. 14. G.S. 105-130.40(b1) reads as rewritten:

"(b1) Eligibility. -- A corporation is eligible for the tax credit allowed by this section only if it obtained a credit under this section for taxable year 1988 or the Department of ~~Commerce~~ Economic and Community Development determines that it engages in the manufacturing of goods, or that it engages in an industrial activity such as the processing of foods, raw materials, chemicals and process agents, goods in process, or ~~of~~ finished products."

Sec. 15. G.S. 105-134.1(11) reads as rewritten:

"(11) Person. An individual, a fiduciary, ~~a partnership, or a corporation.~~ or a partnership. The term includes an officer or employee of a corporation or a member or employee of a partnership who, as officer, employee, or member,

is under a duty to perform an act in meeting the requirements of this Division."

Sec. 16. G.S. 105-134.2 reads as rewritten:

"**§ 105-134.2. Individual income tax imposed.**

(a) A tax is imposed upon the North Carolina taxable income of every individual. The tax shall be levied, collected, and paid annually and shall be computed at the following percentages of the taxpayer's North Carolina taxable income.

(1) For married individuals who file a joint return under G.S. 105-152.1 and for surviving spouses, as defined in section 2(a) of the Code:

On the North Carolina taxable income up to twenty-one thousand two hundred fifty dollars ($21,250), six percent (6%); and

On the excess over twenty-one thousand two hundred fifty dollars ($21,250), seven percent (7%).

(2) For heads of households, as defined in section 2(b) of the Code:

On the North Carolina taxable income up to seventeen thousand dollars ($17,000), six percent (6%); and

On the excess over seventeen thousand dollars ($17,000), seven percent (7%).

(3) For unmarried individuals other than surviving spouses and heads of households:

On the North Carolina taxable income up to twelve thousand seven hundred fifty dollars ($12,750), six percent (6%); and

On the excess over twelve thousand seven hundred fifty dollars ($12,750), seven percent (7%).

(4) For married individuals who do not file a joint return under G.S. 105-152.1:

On the North Carolina taxable income up to ten thousand six hundred twenty-five dollars ($10,625), six percent (6%); and

On the excess over ten thousand six hundred twenty-five dollars ($10,625), seven percent (7%).

(b) In lieu of the tax imposed by subsection (a) of this section, there is imposed for each taxable year upon the North Carolina taxable income of every individual a tax determined under tables, applicable to the taxable year, which may be prescribed by the Secretary of Revenue. The tables prescribed

under this subsection shall be in the form the Secretary deems appropriate, and the amounts of the tax shall be computed on the basis of the rates prescribed by subsection (a) of this section. This subsection does not apply to an individual making a return under section 443(a)(1) of the Code for a period of less than 12 months on account of a change in the individual's annual accounting period, or to an estate or trust. The tax imposed by this subsection shall be treated as the tax imposed by subsection (a) of this section."

Sec. 17. G.S. 105-151(a)(3) reads as rewritten:

"(3) Receipts showing the payment of income taxes to another state or country and a true copy of a return or returns upon the basis of which ~~such~~ the taxes are assessed ~~must~~ shall be filed with the Secretary at, or prior to, the time credit is claimed. If credit is claimed on account of a deficiency assessment, a true copy of the notice assessing or proposing to assess the deficiency, as well as a receipt showing the payment of the deficiency, shall be filed."

Sec. 18. G.S. 105-151.8(b) reads as rewritten:

"(b) In the case of property owned by the entirety, where both spouses are required to file North Carolina income tax returns, the credit allowed by this section may be claimed only if the spouses file a joint return under G.S. ~~105-152.2 [105-152.1].~~ 105-151.1. Where only one spouse is required to file a North Carolina income tax return, that spouse may claim the credit allowed by this section."

Sec. 19. G.S. 105-154(b) reads as rewritten:

"(b) Every partnership doing business in the State required to file a return under the Code shall make a return stating specifically the items of its gross income and the deductions allowed under the Code and the adjustments required by this Division, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributable, and the amount of the distributive share of each individual, together with the distributive shares of corporation dividends. The return shall be signed by one of the partners under affirmation in the form prescribed in G.S. 105-155 of this Division, and the same penalties prescribed in G.S. 105-236 shall apply in the event of a willful misstatement. If a business established in this State is owned by a nonresident individual or by a partnership having one or more nonresident members, the manager of the business shall report the earnings of

the business in this State and the distributive share of the income of each nonresident owner or partner, and shall pay the tax as levied on individuals under ~~G.S. 105-134.2~~ G.S. 105-134.2(a)(3) for each nonresident owner or partner. The business may deduct the payment for each nonresident owner or partner from the owner or partner's distributive share of the profits of the business in this State."

Sec. 20. G.S. 105-156 reads as rewritten:

"**§ 105-156. Failure to file returns; supplementary returns.**

If the Secretary is of the opinion that any taxpayer has failed to file a return or to include in a return filed, either intentionally or through error, taxable income, the Secretary may require from the taxpayer a return or supplementary return, under oath, in such form as the Secretary shall prescribe, of all the items of gross income the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this Division. If from a supplementary return or otherwise the Secretary finds that any taxable income has been omitted from the original return, ~~of~~ he may require the taxable income so omitted to be disclosed to him under oath of the taxpayer, and to be added to the original return. The supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties under G.S. 105-236. The Secretary may proceed under the provisions of G.S. 105-241.1 whether or not he requires a return or a supplementary return under this section."

Sec. 21. G.S. 105-160.2 reads as rewritten:

"**§ 105-160.2. Imposition of tax.**

The tax imposed by this Division shall apply to the taxable income of estates and trusts as determined under the provisions of the Code except as otherwise provided in this Division. The taxable income of an estate or trust shall be the same as taxable income for such an estate or trust under the provisions of the Code, adjusted as provided in G.S. 105-134.6 and G.S. 105-134.7, except that the adjustments provided in G.S. 105-134.6 and G.S. 105-134.7 shall be apportioned between the estate or trust and the beneficiaries based on the distributions made during the taxable year. The tax shall be computed at the following percentages of ~~an~~ the amount ~~equal to~~ of the taxable income ~~multiplied by a fraction, the numerator of which is the~~ of an estate or ~~trust's gross income from North Carolina sources, plus the gross income from sources outside of the State and from intangible sources~~ trust which is for the benefit of a resident of this State, ~~and the denominator of which is the estate or~~

~~trust's gross income as calculated under the Code.~~ or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. For purposes of the preceding sentence, taxable income and gross income shall be computed subject to the adjustments provided in G.S. 105-134.6 and G.S. 105-134.7. The tax shall be at six percent (6%) on the first twelve thousand seven hundred fifty dollars ($12,750) of the amount computed above; and at seven percent (7%) of the excess of the amount computed above over twelve thousand seven hundred fifty dollars ($12,750). The tax computed under the provisions of this Division shall be paid by the fiduciary responsible for administering the estate or trust."

Sec. 22. The title of Article 4A of Chapter 105 of the General Statutes reads as rewritten:

"ARTICLE 4A.

Withholding of Income Taxes from Wages ~~and~~ ~~Filing of Declarations of Estimated~~ ~~Income~~ and Payment of Income Tax by Individuals."

Sec. 23. G.S. 105-163.16(c) reads as rewritten:

"(c) Where there has been an overpayment (as specified in subsections (a) and (b) of this section) of any tax imposed under Article 4 of this Chapter, as disclosed by the taxpayer's annual return required to be filed by Article 4, the amount of such overpayment shall be refunded to the taxpayer; except that overpayments of less than one dollar ($1.00) shall be refunded only upon receipt by the Secretary of a written demand for such refund from the taxpayer and except that there shall be no refund to the taxpayer of any sum set-off under the provisions of Chapter 105A, the Set-off Debt Collection Act. Every refund authorized by this section shall be made as expeditiously as possible, and within six months from the date on which the annual return is filed or due to be filed, whichever is later, insofar as the same is practicable; except that no refunds for overpayment of estimated tax shall be made by the Secretary prior to the date on which the final return is filed by the taxpayer. No interest shall be paid with respect to any such refund if the refund is made within the six months' period above referred to. Interest computed at the rate established in G.S. 105-241.1(i) for assessments shall be paid on refunds made after the expiration of said six months' period, such interest to be

computed from the time of the expiration of said six months' period until paid. It shall not be necessary for the Attorney General or any member of his staff to approve such refund. The making of such refund does not absolve any taxpayer of any income tax liability which may in fact exist and the Secretary may make any assessment for any deficiency in the manner provided in ~~Article 4~~ Article 9 of this Chapter. No overpayment of tax by the taxpayer shall be refunded irrespective of whether upon discovery or receipt of written demand if such discovery is not made or such demand is not received within three years from the date set by the statute for the filing of the annual return by the taxpayer or within six months of the payment of the tax alleged to be an overpayment, whichever date is the later."

Sec. 24. G.S. 105-188(i) reads as rewritten:

"(i) The tax does not apply to tuition payments made on behalf of an individual to an educational institution or to medical payments made on behalf of an individual to a provider of medical care, as defined ~~in G.S. 105-147(11)b1,~~ in the Code for the care of that individual. The term 'educational institution' includes only those institutions that normally maintain a regular faculty and curriculum and normally have a regularly organized body of students in attendance where the educational activities are conducted."

Sec. 25. G.S. 105-204 reads as rewritten:

"§ 105-204. Beneficial interest in foreign trusts.

The beneficial or equitable interest on December 31 of each year of any resident of this State, or of a nonresident having a business, commercial or taxable situs in this State, in any trust, trust fund or trust account (including custodian accounts) held by a foreign fiduciary, shall be subject to an annual tax, which is hereby levied, of twenty-five cents (25¢) on every one hundred dollars ($100.00) of the total actual value thereof less, however, the proportion of such value as is equal to the proportion of the beneficiary's income from the trust, trust fund, or trust account (including custodian accounts) that is attributable to (i) interest received by the fiduciary on bonds, notes or other evidences of debt of the United States, State of North Carolina, subdivisions of this State, or agencies of such governmental units and (ii) dividends received by the fiduciary on shares of stock ~~which, or~~ to the extent that ~~the same, are~~ the dividends would be deductible by ~~the beneficiary in computing his income tax liability under the provisions of subdivision (7) of G.S. 105-147 without regard to the fifteen-thousand-dollar ($15,000) limitation under subdivision (7) of G.S. 105-147;~~ a

corporate shareholder under G.S. 105-130.7(1), (2), (3), (3a), or (5) except that no deduction shall be allowed for dividends deemed distributable from earnings for a taxable period during which the corporation is an S Corporation subject to the provisions of Division I-S of Article 4 of this Chapter; provided, however, that a resident beneficiary of a foreign trust shall be allowed a credit against any tax due under this section for any foreign intangibles tax paid on his beneficial interest in a foreign trust.

The value of the corpus of such trust, trust fund or trust account shall not be considered in computing taxable value hereunder, unless the person subject to the tax:

(1) Has the right to the present possession of an interest therein, and then only to the extent of the value of such present interest; or

(2) Has the present right to receive a part or all of the income realized from the corpus of such trust, and then only to the extent of the present value of such income interest; or

(3) Has created the trust and reserved for himself an income, reversionary or remainder interest therein, and then only to the extent of the present value of such interest."

Sec. 26. G.S. 105-212(a) reads as rewritten:

"(a) None of the taxes levied in this Article or schedule shall apply to religious, educational, charitable or benevolent organizations not conducted for profit, nor to trusts established for religious, educational, charitable or benevolent purposes where none of the property or the income from the property owned by such trust may inure to the benefit of any individual or any organization conducted for profit, nor to any funds, evidences of debt, or securities held irrevocably in a charitable remainder trust meeting the requirements of section 664 of the Code or in a pooled income fund meeting the requirements of section 642(c)(5) of the Code, nor to any funds held irrevocably in trust exclusively for the maintenance and care of places of burial; nor to any funds, evidences of debt, or securities held irrevocably in pension, profit-sharing, stock bonus, or annuity trusts, or combinations thereof, established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees, or the beneficiaries of such employees, if such trusts qualify for exemption from income tax under the ~~provisions of G.S. 105-161(f)(1)a;~~ Code; nor to any funds, evidences of debt or securities held irrevocably in a pension,

profit-sharing, stock bonus or annuity plan established by an employer for the benefit of his employees or for himself and his employees if such plan qualifies for exemption from income tax under ~~the provisions of G.S. 105-141(b)(19);~~ section 401 of the Code; nor to any funds, evidences of debt, or securities held in an individual retirement account described in section 408(a) of the Code, or an individual retirement annuity described in section 408(b) of the Code, if such individual retirement account or individual retirement annuity is exempt from income tax under ~~the provisions of G.S. 105-161(f)(1)c or G.S. 105-141(b)(19).~~ section 408(e) of the Code."

Sec. 27. G.S. 105-228.5 reads as rewritten:

"**§ 105-228.5. Taxes measured by gross premiums.**

Every insurance company and every Articles 65 and 66 of Chapter 58 corporation shall pay to the Commissioner of Insurance, at the time and rates provided in this section, a tax measured by gross premiums from business done in this State during the preceding calendar year, or, for Articles 65 and 66 of Chapter 58 corporations, a tax measured by gross collections from membership dues, exclusive of receipts from cost plus plans, received by such corporations during the preceding calendar year.

Gross premiums from business done in this State in the case of life insurance and annuity contracts, including any supplemental contracts thereto providing for disability benefits, accidental death benefits, or other special benefits, shall for the purposes of the taxes levied in this section mean any and all premiums collected in the calendar year (other than for contracts for reinsurance) for policies the premiums on which are paid by or credited to persons, firms or corporations resident in this State, or in the case of group policies for any contracts of insurance covering persons resident within this State, with no deduction for considerations paid for annuity contracts which are subsequently returned except as below specified, and with no other deduction whatsoever except for premiums returned under one or more of the following conditions: premiums refunded on policies rescinded for fraud or other breach of contract; premiums which were paid in advance on life insurance contracts and subsequently refunded to the insured, premium payer, beneficiary or estate; and in the case of group annuity contracts the premiums returned by reason of a change in the composition of the group covered. Said gross premiums shall be deemed to have been collected for the amounts as provided in the policy contracts for the time in force during the year, whether satisfied by cash payment, notes, loans, automatic premium loans,

applied dividend or in any other manner whatsoever, except in the case of premiums waived by any of said companies pursuant to a contract for waiver of premium in case of disability.

An insurer, in computing its premium taxes, shall pay premium taxes on a premium for the purchase of annuities at the time the contract holder elects to commence annuity benefits, instead of at the time the premium is collected.

Every insurer, in computing the premium tax, shall exclude from the gross amount of premiums all premiums received on or after July 1, 1973, from policies or contracts, issued in connection with the funding of a pension, annuity or profit-sharing plan, qualified or exempt under sections 401, 403, 404, 408, 457 or 501 of the Code as defined in ~~G.S. 105-135(15)~~ G.S. 105-134.1(1) and the gross amount of all such premiums shall be exempt from the tax levied by this section.

Gross premiums from business done in this State in the case of contracts for fire insurance, casualty insurance, and any other type of insurance except life and annuity contracts as above specified, including contracts of insurance required to be carried by the Workers' Compensation Act, shall for the purposes of the taxes levied in this section mean any and all premiums written during the calendar year, or the equivalent thereof in the case of self-insurers under the Workers' Compensation Act, for contracts covering property or risks in this State, other than for contracts of reinsurance, whether such premiums are designated as premiums, deposits, premium deposits, policy fees, membership fees, or assessments. Gross premiums shall be deemed to have been written for the amounts as provided in the policy contracts, new and renewal, becoming effective during the year irrespective of the time or method of making payment or settlement for such premiums, and with no deduction for dividends whether returned in cash or allowed in payment or reduction of premiums or for additional insurance, and without any other deduction except for return of premiums, deposits, fees or assessments for adjustment of policy rates or for cancellation or surrender of policies.

In determining the amount of gross premiums from business in this State all gross premiums received in this State, or credited to policies written or procured in this State, or derived from business written in this State shall be deemed to be for contracts covering persons, property or risks resident or located in this State except for such premiums as are properly reported and properly allocated as being received from business done in some other nation, territory, state or states, and except for

premiums from policies written in federal areas for persons in military service who pay premiums by assignment of service pay.

The tax rate to be applied to gross premiums collected on contracts applicable to liabilities under the Workers' Compensation Act shall be two and five-tenths percent (2.5%). The tax rate to be applied to gross premiums collected on annuities and all other insurance contracts issued by insurers shall be one and seventy-five hundredths percent (1.75%). The tax rate to be applied to amounts collected on contracts of insurance applicable to fire and lightning coverage (except marine and automobile policies) shall be one and thirty-three hundredths percent (1.33%) in addition to the one and seventy-five hundredths percent (1.75%) tax.Twenty-five percent (25%) of the net proceeds of the one and thirty-three hundredths percent (1.33%) tax on amounts collected on contracts of insurance applicable to fire and lightning coverage shall be deposited in the Rural Volunteer Fire Department Fund established in Articles 84 through 88 of Chapter 58 of the General Statutes. Effective July 1, 1988, the tax rate to be applied to gross premiums and/or gross collections from membership dues, exclusive of receipts from cost plus plans, received by Articles 65 and 66 of Chapter 58 corporations shall be one-half of one percent (1/2 of 1%).

The taxes levied herein measured by premiums and/or membership dues shall be in lieu of all other taxes upon insurance companies except: fees and licenses under this Article, or as specified in Articles 1 through 64 of Chapter 58 of the General Statutes of North Carolina as amended; taxes imposed by Articles 84 through 88 of Chapter 58 of the General Statutes of North Carolina; taxes imposed by Article 5 of Chapter 105 of the General Statutes of North Carolina as amended; and ad valorem taxes upon real property and personal property owned in this State.

For the tax above levied as measured by gross premiums and/or gross collections from membership dues exclusive of receipts from cost plus plans the president, secretary, or other executive officer of each insurance company and Articles 65 and 66 of Chapter 58 corporation doing business in this State shall within the first 15 days of March file with the Commissioner of Insurance a full and accurate report of the total gross premiums as above defined or the total gross collections from membership dues exclusive of receipts from cost plus plans collected in this State during the preceding calendar year. The report shall be in such form and contain such information as the Commissioner of Insurance may specify, and the report shall be verified by the oath of the company official transmitting the same or by some

principal officer at the home or head office of the company or association in this country. At the time of making such report the taxes above levied with respect to the gross premiums or the gross collections from membership dues shall be paid to the Commissioner of Insurance. The provisions above shall likewise apply as to reports and taxes for any firm, corporation, or association exchanging reciprocal or interinsurance contracts, and said reports and taxes shall be transmitted by their attorneys-in-fact.

Insurance companies and Articles 65 and 66 of Chapter 58 corporations subject to the tax imposed by this section with a premium tax liability of ten thousand dollars ($10,000) or more for business done in North Carolina during the immediately preceding year shall remit three equal quarterly installments with each installment equal to at least twenty-seven and one-half percent (27 1/2%) of the premium tax liability incurred in the immediately preceding taxable year. The quarterly installment payments shall be made on or before April 15, June 15, and October 15 of each taxable year. The company shall remit the balance by the following March 15 in the same manner provided in this section for annual returns. For taxable years beginning on or after January 1, 1989, each of the three quarterly installments shall be equal to at least thirty-three and one-third percent (33 1/3%) and payment of these installments shall be made on or before April 15, June 15, and October 15 of each taxable year. The balance shall be remitted by the following March 15 in the same manner provided in this section for annual returns.

The Commissioner of Insurance may, by regulation, permit an insurance company to pay less than the required estimated payment when the insurer reasonably believes that the total estimated payments made for the current year will exceed the total anticipated tax liability for the year.

If a company does not meet the installment payment requirement of this section, the Commissioner of Insurance shall assess a penalty on underpayments that is equal to the interest rate adopted by the Secretary of Revenue under G.S. 105-241.1(i). Any overpayment shall be credited to the company and applied against the taxes imposed upon the company under this Article.

The provisions as to reports and taxes as measured by gross premiums shall not apply to farmers' mutual assessment fire insurance companies or to fraternal orders or societies that do not operate for a profit and do not issue policies on any person except members.

With respect to the taxes levied in this section on the equivalent of premiums of self-insurers under the provisions of the Workers' Compensation Act, the reports required herein shall be transmitted to and the taxes collected by the Insurance Commissioner as provided in G.S. 97-100(j)."

Sec. 28. G.S. 105-269.4 reads as rewritten:

"**§ 105-269.4. Election to apply income tax refund to following year's tax.**

Any ~~person~~ taxpayer required to file an income tax return under Article 4 of this Subchapter whose return shows that the ~~person~~ taxpayer is entitled to a refund may elect to apply part or all of the refund to that ~~person's~~ taxpayer's estimated income tax liability for the following year. The Secretary of Revenue shall amend the income tax returns to permit the election authorized by this section."

Sec. 29. G.S. 105-277.3(a) reads as rewritten:

"(a) The following classes of property are hereby designated special classes of property under authority of Article V, Sec. 2(2) of the North Carolina Constitution and shall be appraised, assessed and taxed as hereinafter provided:

(1) Individually owned agricultural land consisting of one or more tracts, one of which consists of at least 10 acres that are in actual production and that, for the three years preceding January 1 of the year for which the benefit of this section is claimed, have produced an average gross income of at least one thousand dollars ($1,000). Gross income includes income from the sale of the agricultural products produced from the land and any payments received under a governmental soil conservation or land retirement program. Land in actual production includes land under improvements used in the commercial production or growing of crops, plants, or animals.

(2) Individually owned horticultural land consisting of one or more tracts, one of which consists of at least five acres that are in actual production and that, for the three years preceding January 1 of the year for which the benefit of this section is claimed, ~~which~~ have either:

a. Been used to produce evergreens intended for use as Christmas trees and met the qualifying or gross income requirements established by the Department of Revenue for the land; or

b. Produced an average gross income of at least one thousand dollars ($1,000).

Gross income includes income from the sale of the horticultural products produced from the land and any payments received under a governmental soil conservation or land retirement program. Land in actual production includes land under improvements used in the commercial production or growing of fruits or vegetables or nursery or floral products.

(3) Individually owned forestland consisting of one or more tracts, one of which consists of at least 20 acres that are in actual production and are not included in a farm unit."

Sec. 30. G.S. 20-80.1(a) reads as rewritten:

"(a) The Commissioner shall cause to be made a sufficient number of distinctive motor vehicle license plates, in the form hereafter provided, for issuance to eligible members of the reserve components of the armed forces of the United States, upon proper application and under such regulations as he deems appropriate. Upon satisfactory proof of eligibility, the commissioner shall collect a fee in an amount equal to the applicable fee under G.S. 20-87 plus ten dollars ($10.00). ~~Fees collected under~~ The additional fee imposed by this section shall be ~~deposited in~~ credited to the Personalized Registration Plate Fund."

Sec. 31. G.S. 20-81.3(c) reads as rewritten:

"(c) One-half of the revenue derived from the additional fee shall be ~~deposited in~~ credited to the Recreation and Natural Heritage Trust Fund established under G.S. 113-77.7. The remaining one-half of the revenue derived from the additional fee for the special personalized registration plates shall be ~~placed in~~ credited to a separate fund designated the 'Personalized Registration Plate Fund'. After deducting the cost of the plates, plus budgetary requirements for advertising, handling, and issuance to be determined by the Commissioner, the revenue in the Personalized Registration Plate Fund shall be transferred quarterly as follows:

(1) Thirty-three percent (33%) to the account of the Department of Economic and Community Development to aid in financing out-of-state print and other media advertising under the program for the promotion of travel and industrial development in this State.

(2) Fifty percent (50%) to the Department of Transportation to be used solely for the purpose of

beautification of highways other than those designated as interstate. These funds shall be administered by the Department of Transportation for beautification purposes not inconsistent with good landscaping and engineering principles.

(3) Seventeen percent (17%) to the account of the Department of Human Resources to promote travel accessibility for disabled persons in this State. These funds shall be used: to collect and update site information on travel attractions designated by the Department of Economic and Community Development in ~~their~~ its publications; to provide technical assistance to travel ~~attraction~~ attractions concerning accommodation of disabled tourists; and to develop, print, and promote the publication ACCESS NORTH CAROLINA. The Department of Human Resources shall make copies of ACCESS NORTH CAROLINA available to the Department of Economic and Community Development for ~~their~~ its use in Welcome Centers and other appropriate Department of Economic and Community Development offices.

(4) The Department of Economic and Community Development shall promote ACCESS NORTH CAROLINA in ~~their~~ its publications (including providing a toll-free telephone line and an address for requesting copies of the publication) and provide technical assistance to the Department of Human Resources on travel attractions to be included in ACCESS NORTH CAROLINA. The Department of Economic and Community Development shall forward all requests for mailing ACCESS NORTH CAROLINA to the Department of Human Resources.

(5) Funds allocated by this ~~section~~ subsection for promotion of travel accessibility and ACCESS NORTH CAROLINA which are not spent and are not obligated at the end of the fiscal year shall not revert but shall be transferred to the Department of Administration for removal of man-made barriers to disabled travelers at State-funded travel attractions. Guidelines for the removal of man-made barriers shall be developed in consultation with the Department of Human Resources."

Sec. 32. G.S. 20-81.5(b) reads as rewritten:

"(b) ~~Fees collected under~~ The additional fee imposed by this section shall be ~~deposited in~~ credited to the Personalized Registration Plate Fund."

Sec. 33. G.S. 20-81.10(a) reads as rewritten:

"(a) The Commissioner shall cause to be made a sufficient number of distinctive motor vehicle license plates for issuance to eligible persons who make application on a form designed by the Division and supply documentation that they were members of the U.S. Military Service and were present at the attack on Pearl Harbor on December 7, 1941. Upon satisfactory proof of eligibility, the Commissioner shall collect a fee in an amount equal to the applicable fee under G.S. 20-87 plus ten dollars ($10.00). ~~Fees collected under~~ The additional fee imposed by this section shall be ~~deposited in~~ credited to the Personalized Registration Plate Fund."

Sec. 34. G.S. 20-81.11(a) reads as rewritten:

"(a) The Commissioner shall cause to be made a sufficient number of distinctive motor vehicle license plates for issuance to eligible persons who make application on a form designed by the Division and supply documentation that they were members of the U.S. Military Service and were recipients of the Purple Heart Award. Upon satisfactory proof of eligibility, the Commissioner shall collect a fee in an amount equal to the applicable fee under G.S. 20-87 plus ten dollars ($10.00). ~~Fees collected under~~ The additional fee imposed by this section shall be ~~deposited in~~ credited to the Personalized Registration Plate Fund."

Sec. 35. Section 4 of this act shall become effective July 1, 1990. Sections 16 and 21 of this act are effective for taxable years beginning on or after January 1, 1990. Sections 25 and 26 of this act are effective retroactively for taxable years beginning on or after January 1, 1989. The remainder of this act is effective upon ratification.

Explanation of Proposal 9

Legislative Proposal 9 makes numerous technical and clarifying changes to the revenue laws and related statutes. The following table provides a section-by-section analysis of the proposed changes.

Section	Explanation
1	Deletes a cross-reference to a statute that was repealed in 1988.
2	Corrects an incorrect cross-reference that was added in 1989.
3	Corrects ungrammatical construction.
4	Effective July 1, 1990, repeals an obsolete, redundant statute providing for licensure of certain emigrant agents. All emigrant agent licenses are now issued under G.S. 105-90, which essentially duplicates 105-90.1. Both the Department of Revenue and the Employment Security Commission confirmed that G.S. 105-90.1 serves no known function.
5	Deletes a cross-reference to a statute that was repealed in 1989 and corrects a cross-reference to a subsection that was renumbered in 1989.
6-7	Clarifies and separates criminal and civil penalties for violation of the Controlled Substance Tax Act and clarifies that interest applies to overdue taxes.
8-9	Clarifies that reporting requirements imposed on law enforcement agencies by the Controlled Substance Tax Act apply only to arrests where drugs seized are subject to tax.
10-11	Deletes language in two franchise tax statutes that relates to provisions repealed as obsolete in 1989.
12	As requested by the Department of Revenue, changes from December 31 to September 30 the cut-off date relating to the return to be used for computing the proportion of dividends deductible for corporate income tax purposes and the stock value not taxable for intangibles tax purposes. The modification is needed by the Department to enable the Intangibles Tax Division to publish annually the booklet, Stock and Bond Values, in a more complete and timely manner.
13	Both the corporate income tax and the individual income tax allow a credit for construction of a fuel ethanol distillery; the 1987 bill rewriting these

Section	Explanation
	credits was amended at the last minute to extend the sunset date from 1993 to 1994 for the individual income tax credit. Apparently through oversight, the corporate income tax credit sunset was not similarly extended. This section would extend the corporate income tax credit sunset date from 1993 to 1994.
14	Updates reference to the former Department of Commerce, now the Department of Economic and Community Development.
15	Removes "corporation" from the definition of a person under the Individual Income Tax Act. Requested by the Department of Revenue.
16	Effective beginning with the 1990 tax year, this section authorizes the Secretary of Revenue to issue individual income tax tables, similar to tables issued by the Internal Revenue Service and many other states. This section will simplify tax preparation for North Carolina citizens. Requested by the Department of Revenue.
17	Makes language changes that were included in a 1989 act but did not take effect due to an error in the coded bill drafting format.
18	Corrects an incorrect cross-reference added in 1989.
19	Corrects an ambiguous cross-reference, thus clarifying that the tax rates for single individuals apply to nonresident partners of a North Carolina partnership.
20	Deletes a stray word that a 1989 act intended to repeal. Due to an error in the coded bill drafting format, the word remained in the statute.
21	Corrects the formula for apportioning estate or trust income by providing the appropriate distinction between income that is for the benefit of a resident of this State and income that is for the benefit of a nonresident. Effective beginning with the 1990 tax year.
22	Deletes a reference to a repealed law.
23	Corrects an erroneous cross-reference to the statutes providing general administration provisions, penalties, and remedies for the Revenue Act.
24-27	Amends gift tax, intangibles tax, and gross premiums tax statutes to delete cross-references to repealed statutes and substitute appropriate cross-references to preserve the substance of the law.
28	Clarifies that corporations as well as individuals may elect to apply all or part of their income tax refunds to the following year's tax liability.
29	Corrects a grammatical error.

Section	Explanation
30-34	Clarifies that while the additional fee for vanity plates is credited to the Personalized Registration Plate Fund, the $20.00 registration fee charged for all passenger vehicles continues to go to the Highway Fund. Corrects grammar and replaces the phrases "deposited in" and "placed in" with the technically accurate phrase "credited to".
35	Provides that all changes are effective upon ratification except as otherwise provided.

PROPOSAL 9

FISCAL REPORT
FISCAL RESEARCH DIVISION
APRIL 16, 1990

Explanation of Proposal:
Makes numerous technical changes to state revenue laws.

Effective Date:
Varies by provision.

Fiscal Effect:
None.

APPENDIX A

PART II.-----LEGISLATIVE RESEARCH COMMISSION

Sec. 2.1. The Legislative Research Commission may study the topics listed below. Listed with each topic is the 1989 bill or resolution that originally proposed the issue or study and the name of the sponsor. The Commission may consider the original bill or resolution in determining the nature, scope and aspects of the study. The topics are:

(1) State Ports--study continued (S.J.R. 96 - Barker, H.B. 133 - Hall), Lease and Renegotiation of Contracts of the North Carolina Railroad Company and the Atlantic and North Carolina Railroad Company,

(2) Development of a State Strategy for the Management of Solid Waste (S.J.R. 112 - Speed, S.B. 1214 - Basnight) and Infectious Wastes (H.B. 1045 - Diggs),

(3) Worker Training Trust Fund (S.B. 271 - Parnell),

(4) Tourism's Growth and Effect--study continued (S.B. 297 - Block, H.B. 379 - Warren) and Travel/Tourism Reorganization (H.B. 1132 - Perdue),

(5) Deregulation of Revolving Credit and Authorization of Credit Card Banks (S.B. 377 - Staton) and Linked Deposits (H.B.1910 - Locks),

(6) Administrative Procedure Act's Rule-Making Process (S.B. 535 - Johnson) and Office of Administrative Hearings and the Administrative Rules Review Commission (S.J.R. 1003 -Martin of Guilford, H.B. 1459 - Michaux),

(7) "Willie M." Programs (S.J.R. 887 - Block),

(8) State Procurement Contracts to Minority Business Enterprises (S.B. 927 - Hunt of Durham) and Small Business Technical Assistance Programs (H.J.R. 1514 - Colton),

(9) Consumer Protection Issues, including those relating to the Elderly (S.B. 1261 - Barker),
(10) State Marine Patrol (S.B. 1267 - Barker),
(11) Sports Fishing Licenses (S.B. 1284 - Barker),
(12) Revenue Laws--study continued, including the impact of 1989 tax law changes (H.J.R. 3 - Lilley) and Local Revenue Sources Options (S.B. 1298 - Odom),
(13) Care Provided by Rest Homes, Intermediate Care Facilities, and Skilled Nursing Homes--study continued (H.J.R. 173 - Easterling), Necessity for Certificates of Need, and Continuing Care Issues,
(14) Health Care/Insurance Costs Issues, including but not limited to, Availability, Benefits, Costs, Portability, Long-Term Care Insurance (H.B. 202 - Wiser), Health Insurance Costs (H.B. 961 - Perdue, S.B. 1068 - Johnson, Joe), Health Insurance (H.J.R. 1159 - Duncan), Infertility Treatment Coverage (H.B. 1187 - Payne), Mammogram/Pap Smear Coverage (H.B. 1014 - Barnes), and Health Care Insurance Coverage (H.B. 1242 - Mills),
(15) Development of a State Strategy for the Protection of All Groundwater Resources (H.J.R. 554 - DeVane, S.J.R. 367 - Winner),
(16) Surface Water Quality and Resources Issues, Including Interbasin Transfer, Albemarle-Pamlico Estuarine (H.J.R. 33 - Ethridge, B.), Coastal Water Quality -- study continued (H.J.R. 37 - Ethridge, B.), Haw in Scenic River System (H.B. 1224 - Hackney), Pesticides (H.J.R. 1399 - Holt), Water Resources Planning (H.B. 1945 - Payne), Toxaway River (H.B. 1955 - Colton), and Yadkin River Use and Protection (S.B. 1182 - Kaplan),
(17) Insanity Verdict (H.B. 1364 - Rhodes), and Guilty but Insane Verdict (H.B. 1372 - Sizemore),
(18) Agriculture Study (H.B. 1362 - Brown), Agribusiness Plant Variances (H.B. 1304 - Bowman), Fallow Deer (H.J.R. 1924 - James),
(19) Homeless Persons (H.B. 2018 - Greenwood, S.B. 1290 - Martin of Guilford),
(20) State Information Processing Needs and Cost -- study continued (S.B. 47 - Royall),
(21) Sports Fishing Licenses (S.B. 1284 - Barker),
(22) Proprietary Schools (S.B. 854 - Martin, W.),
(23) Public Employees' Day Care and Medical and Dental Benefits.

Sec. 2.2. Legislative Activity Between Legislative Sessions and Procedures to Shorten the Legislative Session. The Legislative Research Commission may study the procedures of this State's, other states' and other legislative bodies' practices and procedures regulating legislative and study activity and may make recommendations as to changes in law, procedures and rules that will lead to greater efficiency in the legislative process while safeguarding the rights of all members of the General Assembly and of the citizens in this State's legislative process.

Sec. 2.3. State Capital Assets and Improvements (S.B. 1240 - Sherron). The Legislative Research Commission may study the:

(1) Inventory of State capital assets and the use of those assets,
(2) Issue of preventive maintenance for State buildings, and
(3) Need and feasibility of:
   a. Establishing in the State budget a reserve for repairs and renovations and the administration of such a reserve, and

b. Charging rent to State agencies using State buildings.

Sec. 2.4. Committee Membership. For each Legislative Research Commission Committee created during the 1989-1991 biennium, the Cochairmen of the Commission each shall appoint a minimum of seven members.

Sec. 2.5. Reporting Dates. For each of the topics the Legislative Research Commission decides to study under this act or pursuant to G.S. 120-30.17(1), the Commission may report its findings, together with any recommended legislation, to the 1990 Session of the 1989 General Assembly or the 1991 General Assembly, or both.

Sec. 2.6. Bills and Resolution References. The listing of the original bill or resolution in this Part is for reference purposes only and shall not be deemed to have incorporated by reference any of the substantive provisions contained in the original bill or resolution.

Sec. 2.7. Funding. From the funds available to the General Assembly, the Legislative Services Commission may allocate additional monies to fund the work of the Legislative Research Commission.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

H **1**

HOUSE JOINT RESOLUTION 3

Sponsors: Representatives Lilley; Bowman.

Referred to: Appointments and the Calendar.

January 12, 1989

A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF NORTH CAROLINA.

Whereas, the Legislative Research Commission has been authorized by the 1977, 1979, 1981, 1983, 1985, and 1987 General Assemblies to conduct a study of the revenue laws of North Carolina; and

Whereas, since 1977 the committee appointed by the Legislative Research Commission to study the revenue laws has recommended many changes in the revenue laws in the committee's attempt to improve these laws; and

Whereas, the Revenue Laws Study Committee has proved to be an excellent forum for both taxpayers and tax administrators to present their complaints with existing law and make suggestions to improve the law;

Now, therefore, be it resolved by the House of Representatives, the Senate concurring:

Section 1. The Legislative Research Commission is authorized to study the revenue laws of North Carolina and the administration of these laws. The Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable. When the recommendations of the Commission, if enacted, would result in an increase or decrease in State tax revenues,

the report of the Commission shall include an estimate of the amount of the increase or decrease.

Sec. 2. The Commission may call upon the Department of Revenue to cooperate with it in its study of the revenue laws. The Secretary of Revenue shall ensure that the Department's staff cooperates fully with the Commission.

Sec. 3. The Commission shall make a final report of its recommendations for improvement of the revenue laws to the 1991 General Assembly.

Sec. 4. This resolution is effective upon ratification.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

S **2**

SENATE BILL 1298
Second Edition Engrossed 7/12/89

Short Title: Local Govt. Study/Reimbursement. (Public)

Sponsors: Senators Odom; Basnight, Carpenter, Hardin, Hunt of Durham, Hunt of Moore, Johnson of Cabarrus, Johnson of Wake, Martin of Guilford, Parnell, Richardson, Sands, Speed, and Staton.

Referred to: Finance.

May 11, 1989

A BILL TO BE ENTITLED

AN ACT TO CREATE THE LOCAL GOVERNMENT REVENUE STUDY COMMISSION, TO SIMPLIFY TAX ADMINISTRATION, AND TO ALLOCATE A PERCENTAGE OF STATE INCOME TAX PROCEEDS TO LOCAL GOVERNMENTS TO REPLACE STATE REIMBURSEMENTS FOR PREVIOUSLY REPEALED LOCAL TAXES.

Whereas, the elimination of the federal revenue-sharing program and recent federal legislation increasing the local government cost of the Medicaid program have created needs for additional local government revenue; and

Whereas, recent State legislation has eliminated portions of the property tax base; and

Whereas, local government units in North Carolina must seek State approval for new sources of revenue to meet pressing needs; and

Whereas, the General Assembly finds that local governments may need additional alternative local revenue sources; Now, therefore,

The General Assembly of North Carolina enacts:

PART I.

LOCAL GOVERNMENT REVENUE STUDY COMMISSION.

Section 1. The Local Government Revenue Study Commission is created. The Commission shall study the need for additional local government revenue sources to supplement the property tax, local sales and use taxes, and other existing revenue sources. The Commission shall review recent changes in federal and State law that have reduced financial assistance to local governments, created needs for increased expenditures, and restricted the property tax base. The Commission shall develop proposed options for local revenue sources, including an additional one-half cent (1/2¢) local sales and use tax, a local-option county income tax on county residents and/or people who work in the county, and a local-option county payroll tax. In developing the proposals, the Commission shall consider the fiscal impact of each proposal, how to simplify the administration of each proposal, how to reduce the burden on businesses, individuals, and the Department of Revenue in complying with each proposal, and other practical and legal issues associated with the proposals.

Sec. 2. The Commission shall consist of 14 members to be appointed as follows:

(1) Four members of the Senate appointed by the President Pro Tempore of the Senate, one of whom shall be designated cochair;

(2) Three public members appointed by the President Pro Tempore of the Senate, two of whom shall be local government officials and one of whom shall be a citizen representing the public at large;

(3) Four members of the House of Representatives appointed by the Speaker of the House of Representatives, one of whom shall be designated cochair;

(4) Three public members appointed by the Speaker of the House of Representatives, two of whom shall be local government officials and one of whom shall be a citizen representing the public at large.

Sec. 3. Members appointed to the Commission shall serve until the Commission makes its final report. Vacancies on the Commission shall be filled in the same manner as the original appointments were made.

Sec. 4. Upon request of the Commission or its staff, all State departments and agencies and all local government agencies shall furnish to the Commission or its staff any information in their possession or available to them.

Sec. 5. The Commission shall submit a final report of its findings and recommendations to the General Assembly on or before the first day of the 1991 Session of the General Assembly by filing the report with the Speaker of the House of Representatives and President Pro Tempore of the Senate. The Commission shall terminate upon filing its final report.

Sec. 6. The Commission shall have its initial meeting on or before October 15, 1989. The Commission shall meet upon the call of the cochairs.

Sec. 7. Upon approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional and clerical staff to assist in the work of the Commission. Clerical staff shall be furnished to the Commission through the offices of House and Senate supervisors of clerks. The expenses of employment of the clerical staff shall be borne by the Commission. The Commission may meet in the Legislative Building or the Legislative Office Building upon the approval of the Legislative Services Commission.

Sec. 8. Members of the Commission shall be paid per diem, subsistence, and travel allowances as follows:

(1) Commission members who are also members of the General Assembly, at the rate established in G.S. 120-3.1;

(2) Commission members who are officials or employees of the State or local government agencies, at the rate established in G.S. 138-6;

(3) All other Commission members at the rate established in G.S. 138-5.

Sec. 9. There is appropriated from the General Fund to the General Assembly the sum of $15,000 for the 1989-90 fiscal year, and the sum of $10,000 for the 1990-91 fiscal year to fund the Commission created by this act. Funds appropriated for the Commission for the 1989-90 fiscal year but not expended during that fiscal year may be expended for the Commission during the 1990-91 fiscal year.

Sec. 10. This act shall become effective July 1, 1989.

APPENDIX B

REVENUE LAWS STUDY COMMITTEE

1989 - 1990

Rep. Daniel T. Lilley, Cochair
P. O. Box 824
Kinston, North Carolina 28501

Rep. J. Vernon Abernethy
P. O. Box 38
Gastonia, North Carolina 28012

Rep. C. Robert Brawley
P. O. Box 1322
Mooresville, N. C. 28115

Rep. James M. Craven
P. O. Box 44
Pine Bluff, N. C. 28373

Rep. John C. Hasty
P. O. Box 945
Maxton, N. C. 28364

Rep. Betty H. Wiser
P. O. Box 33361
Raleigh, N. C. 27606

Mr. Earle H. Ward
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Shelby, N. C. 28151-0670

Sen. Dennis J. Winner, Cochair
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Sen. Marshall A. Rauch
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Sen. William W. Staton
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Winston-Salem, N. C. 27104

The Honorable Oscar Harris
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LRC Member responsible for study: Rep. John W. Hurley

Staff: Martha H. Harris, Legislative Services Office,
Bill Drafting Division

Sabra J. Faires, Legislative Services Office,
Fiscal Research Division

David Crotts, Legislative Services Office
Fiscal Research Division

Ruth Sappie, Legislative Services Office
Fiscal Research Division

Cindy Avrette, Legislative Research Division

Ada B. Edwards, Committee Clerk

APPENDIX C

SPEAKERS AT COMMITTEE MEETINGS

SPEAKER	*SUBJECT OF PRESENTATION*
John Jarema North Carolina Department of Human Resources	Double taxation of vehicles used by handicapped
Marvin Musselwhite Poyner and Spruill	Option of paying titling tax on October 1 inventory
Lee Paramore National Association of Retired Federal Employees	House Bill 1350
Secretary Helen A. Powers North Carolina Department of Revenue	Amnesty Program
Tom Slade Interstate Auto Leasing	Uniform long-term leasing rate
Robert B. Womble Poyner and Spruill	Sales tax on alternative fuel used to produce electricity
	Taxes payable by the N.C. Enterprise Corporation
Pat Yancey North Carolina Department of Public Instruction	Exemption from titling tax of driver education vehicles
	Exemption from titling tax of public school buses
James A. Young NCNB Leasing Corporation	Uniform long-term leasing rate

APPENDIX D

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE SERVICES OFFICE
2129 STATE LEGISLATIVE BUILDING
RALEIGH 27611-9184

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LEGISLATIVE ADMINISTRATIVE OFFICER
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LEGISLATIVE INFORMATION OFFICER
TELEPHONE: (919) 733-4200

January 26, 1990

M E M O R A N D U M

TO: Revenue Laws Study Committee

FROM: Sue Floyd and Martha H. Harris

RE: Bills Recommended to the 1989 Session by the Revenue Laws Study Committee

The following is a summary of the disposition of bills that were recommended by the Revenue Laws Study Committee to the 1989 General Assembly.

Legislative Proposal 1: Enacted.

SB 119, A BILL TO BE ENTITLED AN ACT TO REPEAL THE PRIVILEGE LICENSE TAX FOR FLEA MARKET VENDORS, TO INCREASE THE TAX FOR FLEA MARKET OPERATORS, TO EXEMPT GOVERNMENTAL ENTITIES FROM THE TAX, TO REDEFINE FLEA MARKETS AS 'SPECIALTY MARKETS', AND TO INCREASE THE PENALTY FOR CERTAIN VIOLATIONS, was introduced by Senator Guy and ratified as Chapter 435 of the 1989 Session Laws.

Legislative Proposal 2: Pending.

HB 56, A BILL TO BE ENTITLED AN ACT TO MAKE ADVERTISING AGENCIES LIABLE FOR SALES TAX ON ALL ITEMS PURCHASED BY THEM AND TO EXCLUDE ITEMS PRODUCED BY ADVERTISING AGENCIES FROM SALES TAX, THEREBY ENSURING THAT ADVERTISING SERVICES ARE NOT SUBJECT TO SALES TAX, was introduced by Representative Lilley and remains in the House Finance Committee.

Legislative Proposal 3: Pending.

SB 39 and HB 367, A BILL TO BE ENTITLED AN ACT TO ALLOW A PERCENTAGE DISCOUNT TO MERCHANTS FOR COLLECTING STATE SALES AND USE TAXES, were introduced by Senator Guy and Representative Lilley, respectively. HB 367 remains in the House Finance Committee. SB 39 remains in the Senate Finance Committee.

Legislative Proposal 4: Enacted.

SB 50, A BILL TO BE ENTITLED AN ACT TO STRUCTURE INDIVIDUAL INCOME TAX AS A PERCENTAGE OF FEDERAL TAXABLE INCOME, was introduced by Senator Winner and Senator Guy, but not passed in this form. However, SB 51, AN ACT TO ENHANCE THE SIMPLICITY AND FAIRNESS OF THE STATE INCOME TAX SYSTEM, which was substantially similar to SB 50, was enacted as Chapter 728 of the 1989 Session Laws, the Tax Fairness Act of 1989.

Legislative Proposal 5: Enacted.

HB 55, A BILL TO BE ENTITLED AN ACT TO ALLOW A USE TAX CREDIT FOR SALES TAX PAID TO ANOTHER STATE ON CONSTRUCTION EQUIPMENT BROUGHT INTO NORTH CAROLINA, was introduced by Representative Lilley and passed the House. The substance of this bill was incorporated in Chapter 692 of the 1989 Session Laws, the Highway Trust Fund Act.

Legislative Proposal 6: Enacted.

HB 4, A BILL TO BE ENTITLED AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS, was introduced by Representative Lilley and ratified as Chapter 36 of the 1989 Session Laws.

Legislative Proposal 7: Enacted.

HB 5, A BILL TO BE ENTITLED AN ACT TO MAKE TECHNICAL CHANGES TO THE REVENUE LAWS, was introduced by Representative Lilley and ratified as Chapter 37 of the 1989 Session Laws.

Legislative Proposal 8: Enacted.

HB 58, A BILL TO BE ENTITLED AN ACT TO MAKE CONFORMING CHANGES TO THE MOTOR CARRIER FUEL USE TAX SO THAT A UNIFORM TAX REPORTING FORM MAY BE ADOPTED, was introduced by Representative Lilley and ratified as Chapter 7 of the 1989 Session Laws.

Legislative Proposal 9: Postponed Indefinitely.

HB 57, A BILL TO BE ENTITLED AN ACT TO AUTHORIZE POLITICAL COMMITTEES TO MAKE CERTAIN CONTRIBUTIONS, was introduced by Representative Lilley and postponed indefinitely on April 20, 1989.

Legislative Proposal 10: Enacted.

<u>HB 3</u>, A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF NORTH CAROLINA, was introduced by Representative Lilley but did not pass as a separate resolution. However, the study was continued in SB 231, Chapter 802 of the 1989 Session Laws.

APPENDIX E

March 16, 1990

MEMORANDUM

TO: Myron C. Banks
Deputy Secretary

FROM: Michael S. Hodges, Director
Individual Income Tax Division

SUBJECT: Federal Tax Changes Affecting State Individual Income Tax

The federal income tax changes effective in 1990 which will impact our individual income tax are as follows:

Self-Employment Taxes Deduction

The Social Security Amendments of 1983, P. L. 82-21, added subsection (f) to section 164 of the Internal Revenue Code to allow an individual to deduct one-half of the self-employment taxes imposed under section 1401 of the Internal Revenue Code. This subsection provides that the deduction is to be treated as attributable to the trade or business of the taxpayer which means that it will be allowed as an adjustment to income. Although the provision was enacted in 1983, its effective date was delayed until tax years beginning on or after January 1, 1990.

G. S. 105-134.1(1) defines "Code" as "The Internal Revenue Code as enacted as of January 1, 1989, including any provisions enacted as of that date which became effective either before or after that date, but not including sections 63(c)(4) and 151(d)3." Therefore, the deduction for self-employment taxes allowed under section 164(f) of the Code will be reflected in North Carolina taxable income for the tax year 1990 and the effect on income tax collections may be substantial. We are sending Niki Underwood a copy of this memorandum along with statistical information from the Federation of Tax Administrators so that she may estimate the effect on revenue.

Optional Mileage Allowance

For 1989 the optional mileage allowance is 25½ cents per mile for the first 15,000 miles of business use of an automobile during the year and 11 cents per mile of business use for miles over 15,000.

The Internal Revenue Service has announced that with respect to business travel on or after January 1, 1990, the optional mileage allowance is 26 cents per mile for all miles of business use.

Revenue Reconciliation Act of 1989 (Title VII of the Omnibus Budget Reconciliation Act of 1989)

The Omnibus Budget Reconciliation Act of 1989 was signed by the President on December 19, 1989. If our references to the Internal Revenue Code are updated to January 1, 1990, we will adopt the following changes:

(1) Employer-Paid Educational Assistance

Under federal law prior to the 1989 Act, an employee's gross income did not include employer-paid educational benefits up to $5,250 annualy under a qualified educational assistance program.

This exclusion, which was scheduled to expire for tax years beginning after 1988, has been reinstated and extended to tax years beginning before October 1, 1990, but only for amounts paid before October 1, 1990.

(2) Employer Group Legal Services Plan

Under federal law prior to the 1989 Act, amounts contributed by an employer to a qualified group legal services plan were excludable from the employee's gross income to the extent the employer-paid premiums did not exceed $70 a year. Also, the value of the legal services provided under the plan were excluded.

This exclusion which was scheduled to expire for tax years ending after 1988 has been reinstated and extended to tax years beginning before October 1, 1990; however, amounts paid by employers for group legal services coverage must be paid before October 1, 1990, to qualify.

(3) "Like Kind" Exchanges with a Related Party

For exchanges of property prior to July 11, 1989, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of "like kind" which is also held for productive use in a trade or business or for investment.

Under the 1989 Act, exchanges of property with a related party after July 10, 1989, are not eligible for nonrecognition of gain treatment if the property is disposed of within two-years of the exchange.

(4) Long-term Contracts

Under prior federal law, income from long-term contracts was required to be computed under either the percentage of completion method or the percentage of completion - capitalized cost method. Under the percentage of completion - capitalized cost method, a taxpayer was required to take into account 90 percent of the items under the contract under the percentage of completion method. The remaining 10 percent of the items under the contract were required to be taken into account under the taxpayer's normal method of accounting (e.g., the completed contract method of accounting).

The 1989 Act generally repeals the percentage-of-completion capitalized-cost method of accounting for long-term contracts entered into on or after July 11, 1989.

(5) Self-Employed Health Insurance Premiums

The deduction for 25 percent of health insurance premiums by a self-employed individual who was not a participant in a subsidized health plan maintained by an employer was scheduled to expire for tax years beginning after 1989.

The 1989 Act extends this health insurance premium deduction to tax years beginning before October 1, 1990; however, only those premiums paid for coverage before October 1, 1990, are deductible.

(6) Cellular Telephones-Listed Property

Under the 1989 Act, cellular telephones and similar equipment leased or placed in service after 1989 are treated as "listed property" so that MACRS depreciation will not be allowed on such property unless more than 50 percent of their use is in the taxpayer's trade or business. If such use is 50 percent or less, depreciation must be computed under the straight-line depreciation method over a 10-year period, rather than a 7-year period.

(7) Joint Purchase of Term and Remainder Interest

Under prior federal law, a common method of deferring tax was for two related individuals to purchase jointly a term and remainder interest in property. The owner of the term interest was allowed to reduce income from the term interest by the amortization of the cost of the interest. The owner of the remainder interest would have a gain when the property is sold or exchanged.

Under the 1989 Act, no amortization is allowed for a term interest in property for any period during which the remainder interest is held by a related person effective for interests acquired or created after July 27, 1989.

(8) Research and Development Expenses

For taxable years beginning before January 1, 1990, individuals may elect to deduct research and development expenses (R & D) currently instead of capitalizing them. A tax credit may also be available with respect to such expenses, and the deductible amount of R & D must be reduced by 50 percent of the amount of tax credit claimed.

Under the 1989 Act, the deductible amount of R & D expenses must be reduced by 100 percent of the amount of the tax credit claimed effective for taxable years beginning on and after January 1, 1990.

MSH/gb

cc: Niki Underwood